W A Wijewardena: Sustainable socio-economic security – some lessons from the experiences of Sri Lanka

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This paper is based on the personal experiences of the writer as Director of Small Farmers and the Landless Credit Project, dubbed in Sinhala as "Isuru Project", when he was the Director of Rural Credit of the Central Bank of Sri Lanka from 1993 to 2000 and Deputy Governor in charge of this portfolio since then. The credit for the achievements of Isuru Project is shared equally by all the stakeholders involved in the Project. The views expressed in the paper are those of the writer and should not be construed as those of the Central Bank of Sri Lanka.

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Introduction

History is abundant with numerous initiatives taken by mankind, both through state action and personal enterprise, to ensure socio-economic security, or in layman’s language, opportunity for all the people to enjoy the benefits of economic prosperity without discrimination or reservation. In ancient times in Sri Lanka, the kings took it upon themselves the responsibility for creating such a society which was considered as a just society. This trend of state functioning as the main promoter of growth and fair distribution has continued even to the present day. In Sri Lanka, during the last lap of the British rule, the country converted itself into a model welfare state following the example set by the colonial master in the post-war period. Accordingly, education and health care were universalised and made free of charge, a wide range of food subsidies were introduced and state led development initiatives, in social and physical infrastructure, industry and agriculture, were started. All these pro-poor policies were intended to ensure socio-economic security for a wide spectrum of population, allowing the unprivileged to have social mobility through state support and intervention. The model yielded some results such as higher human development, but, economically pushed the country behind many late starters like Singapore or South Korea. Both these countries which were ranked very much below Sri Lanka at the time of independence have graduated to the status of developed countries within a period of just three to four decades reducing their poverty levels from around 50% of the population in 1950s to below 5% by the turn of the century. The creation of “a super welfare state” in this manner without the backing of a proper resource base by Sri Lanka has been criticised by many as an unsound and unsustainable policy compared with that pursued by super-performers in the region.

In this backdrop, some aspects of the welfare state were done away with in late 1970s when Sri Lanka moved to an open economy policy in which growth objectives were pursued through private sector participation and emphasis on export orientation. To facilitate the new growth strategy, economy was liberalised and a flexible exchange rate regime was followed. In the initial decade following the adoption of the new policy, economy responded positively, but at the same time, incidence of poverty too increased to a significant level. By mid 1980s,

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1 Sri Lanka’s two great chronicles, Mahavansa and Culavansa, have praised the kings who in fact followed this policy to the letter. The kings were guided mainly by Kautilya who in his Arthashastra advised the king to “augment his power by promoting welfare of his people” The Arthashastra, Penguin Classics (1987), p 181.

2 Britain’s entry into a fully fledged welfare state was completed after the World War II based on the Beveridge Report. For details, see, Yergin, Daniel & Stanislaw, Joseph, The Commanding Heights, (1998), p 6.

3 For instance, poverty level as a percent of total population which stood at 19% in 1978-79 rose to 27% in 1986-87. SAARC, Meeting the Challenge, (1992), p 5.
it was felt that, unless an effective strategy is adopted to alleviate poverty among those who could not get integrated to the market economy policies, the country was within sight of another socio-economic explosion similar to the one which it experienced in 1971 in the near future⁴. As a counter strategy, several poverty alleviation schemes were initiated by the government with focus on the poor. Along with these schemes, the Central Bank too entered the foray by implementing some pilot projects based on microfinance and support services so that it could develop microfinance techniques and systems for others to emulate. One such project, funded by the International Fund for Agricultural Development (IFAD) and Canadian International Development Agency (CIDA) was implemented by the Central Bank in four districts where the incidence of poverty was the highest under the title “Small Farmers and the Landless Credit Project (SFLCP) or Isuru Project. To supplement this project, another initiative was taken to introduce a Forward Sale Contract Scheme for agricultural produce to facilitate farmers to obtain a pre-agreed price for their major agricultural crops. This paper will cover the strategy, methodology and the techniques adopted in these initiatives so as to develop a sustainable socio-economic security system in Sri Lanka.

The paper is organised into four parts. Part I will critically review some aspects of the current theoretical knowledge on socio-economic security systems from the point of view of cost-effectiveness and sustainability. Part II will present the techniques, methodology and the way-forward strategy of the Isuru Project implemented by the Central Bank as a poverty alleviation project. Part III will discuss the methodology and the future of the Forward Sale Contract Scheme as a price discovery and price-stabilising mechanism for main agricultural produce. Part IV will be devoted to the presentation of a summary and conclusions.

Part I
A critical review of poverty alleviation strategies

A continuous high economic growth over a few decades has been recognised as the main solution for the problem of poverty. While high economic growth reduces the incidence of poverty, it also raises the absolute income of those who still remain in poverty thereby ameliorating their living standards to some extent⁵. Hence, many developing countries in 1950s and 1960s pursued high growth policies as a way out for the poverty stricken masses of their respective countries. When an economy grows and the overall income level increases, it provides opportunities for the poor to secure gainful employment and raise living standards. As an economy proceeds along this path, if investments are made to raise the educational and health standards of the poor, the economy would get into an auto-pilot system moving to still higher levels of output, income and employment. Hence, there is no better alternative than a continuous high economic growth to eradicate poverty on a sustainable basis. However, such growth strategies should perforce provide economic opportunities for the poor to earn income and participate in the development efforts of their respective nations as responsible citizens. This growth strategy, known as inclusive growth, would enable a country to universalise the availability of income earning opportunities to all citizens alike.

There are certain prerequisites which have to be satisfied for a country to gain the best results out of such pro-poor growth policies⁶. Since the main asset which the poor possess is

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⁵ The World Development Report 1990 on Poverty reports that the achievements by some countries in this respect have been dramatic: Indonesia within a generation reduced poverty from 60% to 20% in 1970s and 1980s, p 1.

⁶ Pro-poor growth implies faster growth of income of the lower income categories so that it would not only help the low income people to cross the poverty line but also would bring about a narrowing of income distribution as well. See, World Bank, Economic Growth in the 1990s (2005), p 121.
their own labour, it is these labour services which they could transform into income earning opportunities. Hence, the new job opportunities which the pro-poor growth should create should harness these labour services in full in self-employment and in wage employment. Successful poverty alleviation should focus equally on both these types of labour engagement. When the poor are to be provided with self-employment opportunities, they should have access to land, credit, infrastructure, technology and productive inputs so as to keep their labour services continuously and gainfully employed. Similarly, when the poor are to secure wage employments, both industrial and agro-based enterprises should be promoted in rural as well as urban centres. Any concentration of such enterprises in urban areas would result in an undesirable migration of the poor to urban centres and an uneven development across different regions of a country.

The pro-poor growth strategy in Sri Lanka, as has been the case in other countries pursuing this strategy, has placed heavy emphasis on developing the rural agricultural sector. The reasoning behind this policy would have been the belief that agriculture is the mainstay in the economy and the development of labour intensive agriculture as against capital intensive industry would enable the rural population to increase their income levels. However, this rural bias in growth strategy poses several problems for the sustainability of the policy. First, the policy is urban-neutral and, hence, if the incomes of the urban sector do not increase correspondingly, the rural folk would find it difficult to market their products. This is because, due to the narrowness of the income base, the output of the rural sector cannot be absorbed by the rural sector itself. Hence, the sustainability of the rural poor will depend on active internal trading which they could do with those in the urban sector. Second, the current tendency of the rural population, especially the youth, has been to prefer more lucrative and convenient occupations in the urban sector and not the rural agricultural sector in which their fathers and fore-fathers had been engaged for generations. It has also been found that when the rural poor move from low paying jobs in agriculture to high paying jobs in industry or services in the urban sector, they could conveniently escape poverty. When this internal migration to industry and services is supported by a high level of educational competencies acquired by the poor, the reduction in poverty levels too becomes noticeably greater. As a result, investments made in the rural agriculture sector would go unused without the support from the segment of people for whom they were really meant. Third, rural agriculture suffers from both a growth limitation and a capacity limitation. Agriculture is not a high growth contributor and, over the last two centuries, world’s agricultural output has risen, on average, by less than two percent per annum. Hence, agriculture, despite the heavy volume of investments made, cannot raise rural incomes to a level sufficient to push its population out of poverty. In addition to this growth limitation, there is a capacity limitation too affecting the growth in the agricultural sector. Two main inputs used in agriculture, viz., cultivable land and water, are in short supply inhibiting an effective limitation on its growth. Further, agriculture in

7 Ibid, p 56.
8 For instance, in Sri Lanka, slightly more than a half of the national income is earned by people living in three main districts that make up the more lucrative Western Province. See, Economic and Social Statistics of Sri Lanka 2007 Table 41.
10 Lanka Business Online, provider of an internet based business and economic analyses, has reported results of a survey on the job preferences of the youth in two remote villages off Anuradhapura where none of the youth have selected agriculture as their future job preference. Visit www.lbo.com.
12 Sri Lanka’s case in this context is more disappointing with only an annual average growth rate of 1.1% during 1990-2005. See, World Development Report 2007.
certain areas such as the Western Province has now become commercially unviable on account of ever falling yield levels and rising costs of production. Hence, the over-concentration on agriculture in pro-poor growth strategies appears to be principally supply driven and there are no demanders who actually wish to utilise them to derive benefits. Hence, the continuation of providing state support for rural agriculture, however much it is well intentioned, would trap an unwilling rural population in agriculture, thereby delaying the adjustment which has to take place by way of transferring the excess labour to other gainful areas of the economy and improve the productivity and efficiency of the agricultural sector of the country. This means that the growth strategy should focus on providing gainful employment to the rural poor in other growing areas such as the services sector and integrate it with the global economy so as to ensure income sustainability.

Two main issues have been present in Sri Lanka’s state sponsored poverty alleviation programmes in the past. One was the moral hazard problem and the other was the adverse selection problem. Since the poverty alleviation programmes anticipated providing benefits to selected poor individuals free of charge, those individuals did not have to work hard to receive such benefits. Hence, the schemes did not provide any incentive for participants to work hard and get out of poverty. As a result, individuals who were taken into the schemes preferred to be in the scheme forever, thereby perpetuating poverty and raising the cost of its eradication significantly. A further problem that has plagued the credit schemes meant for poverty alleviation has been the tendency for providing loans at subsidised interest rates. Such subsidies have been prompted by the belief that they would allow the poor to obtain the required credit facilities at affordable costs. However, when credit is subsidised, borrowers would flock around such credit schemes, not because they want to use the funds for gainful self-employment projects, but to enjoy the subsidy and use the funds for other uses. Hence, borrowers of such subsidised credit have the pre-intention of misusing the funds and eventually defaulting the loans thereby passing a cost on the lending institutions. As a result, such borrowers are adversely selected right at the beginning and those credit schemes are doomed to failure. Hence, the more important requirement for sustainable poverty alleviation is not subsidised credit, but the rectification of impediments such as lack of physical, human and financial infrastructure and absence of competition and efficiency.

Part II
Sustainable poverty alleviation: lessons from the Isuru Project

As mentioned above, mid-1980s became a crucial period in the history of Sri Lanka with rising poverty levels at both the national level and in isolated pockets. It, therefore, became necessary for Sri Lanka to address this issue on a priority basis. Accordingly, supported by IFAD and CIDA with funding, Central Bank of Sri Lanka (CBSL) pioneered a model poverty alleviation project in four selected districts in 1989. The Project, titled Isuru Project, had as its objective, uplifting the economic and social conditions of the poorest of the poor with a

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13 The yield ratio of paddy between the Western Province and more productive areas has been around 1:3.
14 In an earlier paper, the writer argued that Sri Lanka’s future depends on the services sector well integrated to the global economy. See, Professor Sirisena Thilakaratne Memorial Lecture, 2006.
15 Moral Hazard is not a new problem. According to the Buddha, the king in a kingdom found his citizens getting engaged in all types of thefts and robberies. On finding that they did so because they did not have any capital to start a livelihood, he gave funds to them from his treasury freely. People finding that, if they got into thefts more they could get more free funds from the king, committed more robberies and thefts. Chakkavatti Seethanada Sutra, Anguttara Nikaya.
17 Districts involved were Galle, Matara, Kandy and Puttalam where the incidence of poverty was considered the highest in the country.
view to helping them to cross the poverty line within a given period and establishing the methods and techniques of sustainable poverty alleviation for emulation by other interested parties. The poorest of the poor were identified as those whose income was below Rs. 3000 per annum, the minimum income necessary to buy the required daily calorie level of 2250 per adult in terms of the price levels in 1989. In order to bring about a gender balance in sharing economic prosperity, the project envisaged to have, out of the total beneficiaries, at least 40% as women beneficiaries. The project was to be closed at end-1997, but the project agreement provided for its continuation for further 20 years by recycling the loan repayments so that the project objectives could be continued to be realised on a long term basis. The Project was a partnership among a number of stakeholders: government, banks, donors, community based organisations and beneficiaries.

The project adopted a modified group lending mechanism with credit plus approach for delivering its services to the target beneficiaries, selected under a self-selection process by getting the target individuals to select their own group partners from among people of similar conditions. As such, individuals in elitist groups were kept out from becoming beneficiaries of the project, since they did not have incentives to move along with the poorest of the poor. This system ruled out political, bureaucratic or elitist intervention in the selection process and thereby ensured that only the deserving groups were mobilised to receive project benefits. By using a trained field officer network that functioned as change agents, the self selected beneficiaries were taken through a mandatory savings inculcation scheme and a social mobilisation cum leadership development programme. The mandatory savings scheme was intended to inculcate in the beneficiaries the value of thrift as an integral part of making any sustainable livelihood. This is because without learning how to save, an individual is unable to learn how to spend wisely. Accordingly, each member of the group was required to save per week a minimum of Rs. 5 in a group savings account which later served as an insurance against unexpected future eventualities such as family illnesses or crop or business failures.

Group members were encouraged to meet in rotation in one of the member houses at least once a week so as to ensure group cohesiveness and facilitate member education programme. At these meetings, they were encouraged, guided by the change agent, to discuss among themselves freely why they were poor, what skills they were lacking for gainful enterprise, the working of the free market system and how they could benefit by being integrated to the market system. These meetings also gave them vital training on how they could conduct meetings democratically and listen to each other without being offended or having to embarrass others when a disagreeable opinion is made. Groups were chaired by a member who was also selected by rotation and records of group meetings were kept by a member who functioned as its secretary.

Once a group has completed about six months of mandatory savings and gone through the essential elements of social mobilisation, its members would be provided with an opportunity to acquire vocational skills as a prelude to preparing them to be future micro entrepreneurs. With this training, members are also encouraged to select their own micro enterprise and the change agents do not advise them what they should select. The only advice given to these up and coming micro entrepreneurs is that they should select any business line where the output could be sold within a radius of 15 km. from their homes. This way they were guided

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18 This is in line with the traditional local culture which has always upheld savings as a core value of life. Even according to Buddhist scriptures, a wise household should save at least a quarter of his income as a safeguard against unforeseen events use a half of his income for further wealth creation. See, Singalowada Sutra. Dheega Nikaya.

19 In fact, as to be expected, the members initially resisted that they could not save that much when they did not even earn that amount of money. But, when it was shown to them that there was a vast amount of resources lying idle around them which could be tapped and they could cut certain inessential expenditures, they willingly participated in the savings programme.
to produce for the market and keep their selling costs at an affordable level. Many micro enterprises fail within the first few years of operation, if the producers do not pay heed to this vital requirement. The distancing of the project management from the selection of business line is a well thought out process, because it forces the beneficiaries to make business decisions and take responsibility for same. To build their capacity to make these decisions, training was provided as to how they should conduct simple and quick market surveys and how they could satisfy the quality requirements expected by their customers.

After the beneficiaries have selected their business projects, they are referred to the relevant regional development bank for funding support. In view of the speciality and complexity of the loan objectives, micro loans are granted to beneficiaries on the strength of a mutual guarantee or an interse guarantee. If any member of a group defaults the loan, other members of the group are called upon to repay the loan. This ensures credit discipline and compels the members of the group to be constantly alert and vigilant on how a member of a group is using the funds lent to him, because if he defaults, the other members have to bear the burden of repaying the loan of the defaulting member. The peer pressure exercised by members on each other is a better loan management and monitoring system than what the mainstream bankers usually do through their branch network and local staff.

Interest rates charged from the borrowers were set deliberately at levels higher than the normal going rates in the market to avoid any subsidy element. This was necessary to maintain credit discipline, keep undeserving groups away from the project and ensure the long term viability and sustainability of beneficiaries who now have to reckon market costs when preparing micro business plans. The failure of many microfinance projects to realise their goals in many parts of the world can be traced to the failure of the promoters to adopt market based interest rates when designing credit schemes. The objective of subsidising the rates has been to make available low cost funds to the poor, but the subsidy itself generates an excess demand for funds and leads to a higher transaction cost for the borrowers. The transaction cost comes in the form of the opportunity cost of time, money and energy of the borrowers who now have to spend days and days around bank branches to have their loans approved and funds released. Hence, subsidised credit, instead of helping the poor, drives the poor to a greater agony and does not serve its true purpose.

Training, in both skills development and leadership, formed an integral part of the Isuru Project. This is because training was necessary to convert an otherwise unbankable group of poor people into bankable individuals with a high credit discipline and determination to take effective lasting measures to come out of poverty. Since this category of people is unable to pay for their capacity development at the initial period of their entry to the project, training was provided in the form of a free grant. Since only the deserving poor people were admitted to the project through the self-selection process, the misuse of this free grant by project beneficiaries could be kept at a minimal level. Training of beneficiaries, an essential human capital development initiative, was instrumental in developing a highly disciplined group of men and women under the umbrella of the Isuru Project.

In order to empower women in poverty and bring them to the mainstream of economic life, the project envisaged to accommodate a minimum of 40% of poor women as beneficiaries. However, when the project got started, it was immensely popular among women compared

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20 For instance, on-lending rates were set at 20% p.a., when the prevailing market rates were around 16% p.a.

21 The experience in other parts of the world has also been the same. See, Owens, John V & Agabin, Meliza H, “Experiences of the Philipsnes’ Rural Banks in Microfinance” Finance for the Poor ADB, June, 2006, p 3.

22 The degree of the self-discipline of Isuru beneficiaries could be tested in 1994 when the then government announced a politically popular loan forgiveness scheme for farmers. Immediately after the announcement, recovery rates of other agricultural schemes fell from around 75% to around 30%. But the Isuru Project was able to maintain its recovery rate at 97%, because its beneficiaries could not be lured by the short-term gain offered by the loan forgiveness.
to men. As a result, the overall women’s participation in the project remained as high as 70% throughout the project period. They played a very active role in all areas of project work including training, saving, borrowing and taking leadership. It was observed that women were better participants due to several reasons. First, they had the patience to go through the hectic but the rewarding long process of beneficiary development laid down by the project. Second, they had the best interest of their families throughout the period and did not waver after they had begun their move along the prosperity path. Third, women were better savers and also better borrowers with a pronounced reluctance to be branded as loan defaulters. Fourth, their high academic standards enabled them to carry out different functions involving accounts record keeping. Fifth, unlike men who got into social vices when the income level went up, women remained permanently committed to the family and the project. Sixth, they had the leadership ability dormant with them and the project was able to bring out that competency to the fore. As a result, all the leading roles in the project were played by women who formed the majority 23.

The Isuru Project enlisted the expertise, experience and the capacity of grass root level organisations in delivering the project services as retailers. Hence, the project was instrumental in the capacity development of a large number of community based non-governmental organisations. This paved the way for the development of a large number of microfinance institutions which formed the microfinance infrastructure of the country. Some of these institutions operate at the national level and have the capacity to mainstream and become national level formal financial institutions 24.

It was necessary to assess the success of the project from the point of view of its main objective, i.e., helping the poorest of the poor to cross the poverty line within a given period of time. To assess this, two impact assessment surveys were conducted by the project office by employing hired field workers specifically trained for this purpose 25. The findings of the two surveys are basically similar and have vindicated the cost incurred in financing the project:

- The head counting of the surveyed beneficiaries revealed that the percentage of female participants was around 67%, thereby confirming the national average (1997). This had increased to 73% by 2005.
- 75% of the beneficiaries had attended schools and were able to read and write (1997). This literacy rate was somewhat below the national average of 92%, but can be explained as due to the abject poverty with which the group under reference was afflicted and therefore had been disadvantaged. However, the literacy rate of the project beneficiaries had increased to 97%, very much higher than the national average, by 2005.
- The Survey 1997 revealed that 80% had crossed the poverty line within 6-7 years of joining the project, while a further 2% had increased income, but was still in poverty (1997). By 2005, the poverty levels measured in terms of the threshold income used by the Department of Census and Statistics of Sri Lanka had increased, but still

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23 When the project formed limited liability people’s companies at a later stage, all the positions of directors were filled by women having been elected by the shareholders. Not a single man could get elected as a director. Since the constitution required having at least two male directors, two women directors elected by shareholders had to step down to pave the way for two males in terms of the constitution.

24 One such partner of the Isuru Project, viz., Thrift and Credit Cooperative Societies or SANASA, has since formed its own specialized bank under the name Sanasa Development Bank.

25 The first survey conducted in 1997 surveyed a sample of 1425 beneficiaries, while the second survey conducted in 2005 had a sample size of 5238 beneficiaries. The first report is in the form of an unpublished internal document (Survey 1997), while the second one has been published under the title Report on the Impact Assessment Survey of the SFLC Project 2005 (Survey 2005).
about 67% had crossed the poverty line with the support given by the project (2005, p 34). The survey attributes the higher incidence of poverty to the higher income level needed to be above poverty level due to the higher inflation during 1997-2005, a fact which confirms that inflation harms the poor more harshly than the rich.

- 11% of beneficiaries had acquired land after joining the project (1997). The total land ownership had increased to 91% by 2005. 44% of land acquisition in 2005 had been for residential purposes and 16% for both residential and commercial purposes, indicating that the beneficiaries had moved to land owning status with the support of the project.

- The asset build-up among beneficiaries, an indicator of economic well-being of the poor, has accelerated since they had joined the project. The types of assets include agricultural and non-agricultural implements, draft and livestock animals, household consumer durables and jewellery. According to Survey 1997, 20% of the beneficiaries had acquired agricultural and non-agricultural implements, 27% draft and livestock animals and 72% consumer durables and jewellery since joining the project. By 2005, the proportion of beneficiaries owning agriculture and non-agricultural implements increased marginally to around 22%, but the acquisition of consumer durables went up significantly to a fraction between 80 – 100%. This confirms the general tendency that, with income increases, there is a greater preference for consumption type durables than for investment type durables.

- The housing stock of all the beneficiaries has improved significantly after they had joined the project. Self-owned houses have increased from 76% before joining the project to 88% after joining the project. But the quality of the house has improved impressively: tiled roofs from 55% to 67%; cement walls and floors from 62% to 83%; pipe borne water from 9% to 24%; electricity from 46% to 78%; water seal toilets from 63% to 90% and no toilets from 5% to 2%.

With the beneficiaries showing a remarkable improvement in their income levels and living conditions after participating in the project, it was necessary to plan for the sustainability of the project activities. What was mostly necessary was the ability of the project to continue its operations and the beneficiaries to mainstream after the central bank withdrew from the scene. The project did not suffer at all when the donor funding ceased in 1998, because the central bank continued with the work without interruption. However, the fate of the project was not to be the same, when the central bank support would cease to be available to the project. Hence, it was necessary to ensure that the beneficiaries are self-supporting and self-reliant.

This was planned by the project management in three stages.

In the first stage, it was found that the small groups consisting of about 5 to 6 members did not have the strength which a larger group of members would enjoy. So, clusters numbering about 8 to 10 groups were set up by making informal arrangements for them to work together. Separate cluster rules were prepared and the members were trained in keeping cluster accounts and records. This process went on continuously for about 12 to 18 months from the beginning of 1999. When the newly formed clusters showed sufficient maturity of being able to operate independently, the next move for the project was planned by the project.

In the second stage, it was necessary to give legal status to the clusters. Many options like registering them under the law relating to cooperatives or under the Companies Act were considered, but finally, decision was made to incorporate the clusters under the Societies Ordinance as limited liability societies under the name “Isuru Development Society Ltd”, for the simplicity it provided to the beneficiaries. The societies were registered with the Registrar of Companies in terms of the Ordinance. The societies so registered had the objective of realising a common goal of attaining economic well-being of the members with a mutual
Part III
Forward sale contract system: a mechanism to ensure price stability in agricultural produce

A perennial problem faced by farmers world throughout has been the wide fluctuation of prices of agricultural produce between seasons. During the season when there is a glut of production, prices tend to fall to uneconomic levels making the producers economically bankrupt. During the off-season, production would fall to low levels, raising the market prices and thereby emitting a wrong signal about the profitability of these agricultural crops. This unsavoury market development has occurred in cycles making the farmer community
vulnerable, allowing political groups with ulterior motives to exploit farmer sentimentalities and calling for government intervention to protect farmer interests at the cost of tax payers.

The heaviest economic cost of wide price fluctuations is the inability to discover future price developments and plan out the future production accordingly. In developed countries, the issue has been solved to a great extent by the development of forward and futures markets for commodities. When both producers and buyers participate in futures transactions, both parties, having assessed the market information available to them, lock themselves in prices that would fairly rule the market in the future. Hence, the absence of a forward sale mechanism in a formal form in Sri Lanka was considered a serious setback to stabilise the incomes of farmers and thereby ensure socio-economic security. In view of this deficiency, the Central Bank stepped in 1998 to introduce a forward sale contract system to ensure an agreed price for the major agricultural crops produced by the farmer community.

The enforcement of the forward contracts was done in terms of the provisions of Sale of Goods Ordinance enacted during the British Period. In terms of this law, people could get into sales contracts and violation of the contract by either party was considered an offence which would permit the aggrieved party to seek redress through courts of law. While the Central Bank provided the guidelines and the mechanism of the system by connecting the farmers to the would-be buyers of products, commercial and development banks functioned as facilitators, financiers and guarantors of the contracts. Initially, the major crops such as paddy, corn, onion, ginger and sesame were brought under the system. The success of the scheme could be gauged from the very negligible incidence of violating the contracts by either the farmers or the buyers during this whole period\(^{27}\).

The system of forward sale contracts has led to the improvement of the quality of products as well. Since the buyers stipulated the quality specifications in the contract itself, the farmers had to change their production methods to meet the required quality standards. This change has specifically occurred in the case of producing paddy for seed paddy purposes and corn for producing nutritious pre-natal food requirement of pregnant mothers. In addition, the system provided a market guaranteed price to both buyers and producers enabling them to plan their cash flows properly. It also helped both parties to raise loans from banks for both working capital and investment capital purposes.

The future sustainability of the forward sale contract system will depend on the establishment of proper futures market for commodities in Sri Lanka. It is ironical that Sri Lanka, being a country famous for its rich spices throughout history and three major commodities, viz., tea, rubber and coconut, in the last 150 years, has to think of setting a futures market in the country at this late stage, when all the other countries in the region have moved much ahead in that context. However, the initial work relating to the establishment of a futures exchange is presently being done with the initiative taken by the Central Bank. Technical assistance for this purpose has been received from the Futures Commodities Exchange in India and the exchange is to be set up within the next 2 year period.

**Part IV
Summary and conclusions**

This paper examined the strategies adopted by Sri Lanka, with the initiative of the Central Bank of Sri Lanka, to introduce a sustainable socio-economic security system based on the principles of the market mechanism. Despite the popular belief that the poor need subsidised

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\(^{27}\) In fact, the system was largely saved by the flexible approach of buyers when the market price was significantly higher than the contract price of a produce. To prevent farmers from resorting to out-selling for short-term price benefits, buyers on many occasions agreed to raise the contract price to assure them an uninterrupted supply line. However, it is encouraging to note that the established farmers could not be lured by these temporary gains and preferred to enjoy long-run relationships with buyers.
credit and continuous government patronage to cross the poverty line and join the mainstream of the economy, the Central Bank’s Isuru Project, coupled with the forward sale contract system, has been able to establish a more effective poverty alleviation system through the market mechanism. The success of the Isuru Project in this respect is due to the following features unique to the project:

- Selection of beneficiaries was free from political or other elitist interference and done by the beneficiaries themselves through a self selection process. Hence, undeserving elements were kept out of the project activities.
- Interest rates were deliberately set above the normal market rates so as to compel the borrowers to reckon the cost of funds in their project planning and avoid the misuse of funds.
- Lending was done on easy terms and procedures similar to the systems followed by informal money lenders. The objective was to eliminate money lenders competitively by providing a better service at a lower rate.
- Thrift and savings preceded lending to inculcate proper conservation habits among beneficiaries. The underlying rationale is that a person who does not know how to save does not know how to spend money too.
- Beneficiaries were socially mobilised prior to providing funding so as to create solid customers for banks. This provided a permanent resolve to beneficiaries to go through the hard path of moving out of poverty.
- The group lending system consolidated into Development Societies at the village level and People’s Companies at the district level enabled the project to set up very vital networks in the form effective social capital. It also helped the project to ensure the sustainability of the project when both the foreign funding and Central Bank’s patronage were withdrawn.
- Skills and capacity development of the beneficiaries were conducted continuously in order to make them better entrepreneurs and bankable customers. This helped them to receive a continuous flow of funds for meeting their working capital and investment capital requirements.
- The group savings fund set up under each group helped to provide insurance to the beneficiaries in the event of unforeseen emergencies. In this manner, the beneficiaries were taught the vital lesson of self-reliance and self-accountability.
- The forward sale contract scheme introduced along with the project helped the beneficiaries who borrowed for agricultural purposes to enjoy a stable price system for major crops and be free from disastrous price fluctuations.

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