# The Effect of Decentralization of Power on Economic Development: The Sri Lankan Experience

**D. I. J. Samaranayake and J. G. Sri Ranjith**

*Department of Economics and Statistics, University of Peradeniya, Sri Lanka*

***Keywords:*** *Provincial council system; Devolution of power; Regional GDP; Government expenditure.*

## Introduction

Economic development at the regional level was regarded as an expected major intention with the commencement of the Provincial Council (PC) system in 1987. However, even after almost three decades of power devolution the expected outcome of the PC system is seemingly yet to be realized. Regardless of the fact that the current practice of regional development policy under the PC system is less effective, successive regimes, including the current, have made no clear decision to abolish it. According to Uduporuwa (2007), development strategies implemented by Sri Lanka within the past fifty years have not contributed to reduce the socio-economic disparities in Sri Lanka. Gunaruwan and Samarasekara (2013) found that the PCs spend largely on emoluments and spend for their own existence rather than for economic development at regional level. These arguments therefore raise the question on the rationality of continuing with the existing PC system in Sri Lanka.

The theoretical aspects of power devolution show the severe limitations of centrally controlled national planning. Rondinelli and Cheema (1983) say that decentralization allows greater representation for various political, religious, ethnic and tribal groups in decision making that could lead to greater equity in the allocation of resources and investment. This mechanism allows officials to disaggregate and tailor development plans and programs at sub-national levels. According to Sri Ranjith (2007) decentralization occurs when powers and responsibilities are transferred to local levels with management functions of fiscal, financial, personnel and legal authority. Although there are diverse views on this topic, the lack of proper investigation into what determines the regional growth and the strengths of respective regional driving forces will leave this debate unsolved. This research therefore investigates the effect of regional development driving forces under the PC system in Sri Lanka.

## Objective

The major objective of this study is to investigate the relationship between Provincial GDP share and provincial variables such as population, education, poverty and infrastructure services.

## Methodology

The study uses panel data analysis to achieve its objectives, using data from 1995 to 2011. The study uses the following Fixed Effects Model (FEM) in the regression analysis:

$$Y_{it} = \beta_0 + \beta_1 PDP_{it} + \beta_2 ROADS\_KM_{it} + \beta_3 UN\_EMP\_R_{it} + \varepsilon_{it} \quad ..(1)$$

where$Y_{it}$ represents the GDP share of the $i^{th}$ PC at the time period $t$;$PDP_i$ for the population density by $i^{th}$ province; $ROADS\_KM_{it}$ for the degree of road development in the $i^{th}$ province at the time period $t$; $UN\_EMP\_R_i$ for unemployment rate by $i^{th}$ province at the time period $t$; and $\varepsilon_{it}$for residuals.We hypothesized a positive relationship between $Y_{it}$and $PDP_{it}$, $ROADS\_KM_{it}$ and a negative relationship with the $UN\_EMP\_R_{it}$. The regression results were estimated under three model specifications i.e. Fixed Effect, Random Effect and Pooled regression. Finally, the most appropriate model specification was selected for the analysis and discussion.

## Results and Discussion

The results from the regression analysis under Fixed Effect Model (FEM) express how variables in the model are important as determinants of PCs GDP share.

Table 1: Results of Regression Estimation for the Provincial Fixed Effect Model

Dependent Variable: GDP_SHARE

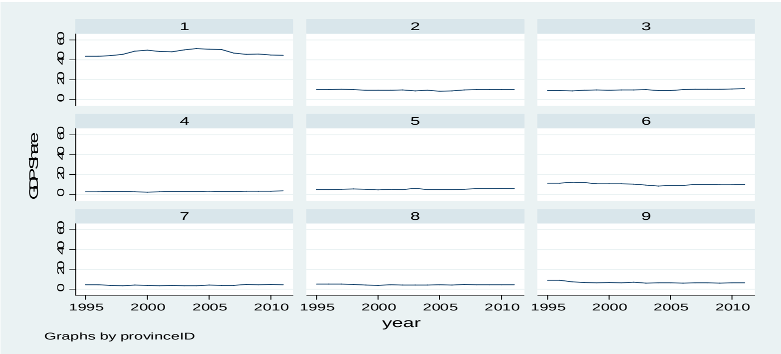
| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|---|---|---|---|---|
| C | 10.85762 | 4.064953 | 2.671033 | 0.0085 |
| UN_EMP_R | -0.002069 | 0.053859 | -0.038415 | 0.9694 |
| PDP | 0.004176 | 0.002396 | 1.743272 | 0.0835 |
| ROADS_KM | -0.001054 | 0.002843 | -0.370769 | 0.7114 |

**Effects Specification**

| Cross-section fixed (dummy variables) | | | |
|---|---|---|---|
| R-squared | 0.993747 | Mean dependent var | 11.11242 |
| Adjusted R-squared | 0.993259 | S.D. dependent var | 13.05465 |
| S.E. of regression | 1.071830 | Akaike info criterion | 3.051796 |
| Sum squared resid | 161.9834 | Schwarz criterion | 3.289477 |
| Log likelihood | -221.4624 | Hannan-Quinn criter. | 3.148346 |
| F-statistic | 2037.070 | Durbin-Watson stat. | 0.574771 |
| Prob(F-statistic) | 0.000000 | | |

The above results showed that hypothesized relationships are correct except for the road development. Also the expected negative sign was observed between the unemployment rate and the GDP share, but it is not statistically significant which says that the unemployment rate is not a determinant of PCs GDP share. Population density shows a positive but weakly significant at 10% level as a determinant factor for PCs GDP share. Due to the low level of statistical significance from population density to GDP share, the study uses descriptive data analysis to identify the potential effect from population to GDP share.

Figure1: Provincial GDP Share




Source: Authors' calculations

Note: Numbers 1-9 indicate, Western, Central, Southern, Northern, Eastern, Wayamba, North Central, Uva and Sabaragamuwa Provinces respectively.

The results indicate that more than 50% of the GDP share is contributed by the Western province throughout the period of 1995-2011. Other provinces share the rest of the GDP. Therefore, it seems government expenditure does not commensurate with size of the population and area of the provinces.

## Conclusion and Policy Recommendations

The study concludes that the current practice of regional development through the PC system does not seem to be sufficiently effective in minimizing regional development disparities. Western Province still mostly benefitted than others. The PC system in Sri Lanka is not about effectiveness of the system itself but it is a problem with extent of power devolution made by the central government.

Therefore, Sri Lanka should either implement decentralization policies meaningfully or correct the fiscal and monetary policies at national level to overcome the barriers against the balanced economic growth to achieve its regional development objectives. Hence, measures need to be taken to devolve more powers to the local levels with closer understanding of the local requirements of the PCs. Also further research is encouraged as to understand more deeply on how road development negatively affect on regional GDP share incorporating more explanatory variables such as labor migration and education across PCs using spatial econometrics.

## References


Gunaruwan, T. L. and Samarasekara, T. D. (2013) 'Economic Effectiveness of the Devolution of Power to Provincial Councils in Sri Lanka: A Resource Productivity Analysis'. Proceedings – 2nd International Economic Research Conference of the Sri Lanka Forum of University Economists.University of Peradeniya. p. 205-215.

Rodinelli, A. D. and Cheema, G. S. (1983) Decentralization in Developing Countries; A Review of Recent Experience. The World Bank, Washington, D. C.

Sri Ranjith, J. G. (2007) Governance and Community Participation: A Collective Approach to Regional (Urban) Development in Sri Lanka. *The Peradeniya Journal of Economics*, 1(1 & 2), p. 28-52.

Uduporuwa, R. J. M. (2007) Regional Dimensions of Development in Sri Lanka. *Sabaragamuwa University Journal*, 7(1) p. 22-36.