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Like many other developing countries Sri Lanka also followed liberal and structural adjustment policies to overcome macro economic imbalances. The impact and implications of these policy reforms on the domestic agricultural sector is very crucial in a situation where production subsidies and incentive packages are implemented to protect local farmers. Since 1977, Sri Lanka also changed agricultural policies in order to transfer subsistence paddy farming system towards a more commercialized farming system. The impact of these policy reforms is very exciting and affected very negatively for the small producers, but it shows positive trends in increasing production efficiency both in terms of cropping intensity and total output. The existing gaps in increasing production and improving livelihood of small farmers are related with socio-political factors inherited in the rural economy.