THE ECONOMIC AGENDA AND THE PEACE PROCESS
2000 – 2005
Part of the Sri Lanka Strategic Conflict Assessment 2005

Sunil Bastian
The Economic Agenda and The Peace Process

By Sunil Bastian

Sri Lanka Strategic Conflict Assessment 2005

Part of The
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Acronyms

ADB Asian Development Bank
CFA Ceasefire Agreement
EU European Union
GoSL Government of Sri Lanka
IDA International Development Association
IFAD International Fund for Agricutural Development
ISGA Interim Self-Governing Authority
IMF International Monetary Fund
LTTE Liberation Tigers of Tamil Eelam
PR Proportional Representation
PRGF Poverty Reduction Growth Facility
PRSP Poverty Reduction Strategy Paper
PRSC Poverty Reduction Support Credit
TULF Tamil United Liberation Front
UPFA United People’s Freedom Alliance
UNF United National Front
UNP United National Party
Sri Lanka Muslim Congress
TULF Tamil United Liberation Front
SMC
PRES
PRC
PRGF
PR
PA
NGO Non-Governmental Organization
TULF Tamil United Liberation Front
JVP Janatha Vimukthi Peramuna
IMF
ISGA
IFAD
IDA
EU
CFA
ADB
Executive Summary

INTRODUCTION

This report is a contribution to a broader study entitled, “Aid, Conflict and Peacebuilding in Sri Lanka” (Goodhand and Klem, 2005), which examines the peace process in Sri Lanka with a particular focus on international engagement. This particular background study focuses on the relationship between the economic agenda of the United Nations Front (UNF) government and the peace process it initiated by signing the February 2002 Ceasefire Agreement (CFA). The UNF government tried to carry out an extensive programme of reforms on the economic front while initiating a difficult process of political negotiations with the Liberation Tigers of Tamil Eelam (LTTE). The basic conclusion of the study is that the political fallout from the economic reform program undermined the peace process, signified by the defeat of the UNF government in April 2004.

The paper argues that the politics of donor countries and multilateral organizations contributed to this defeat. During this time, the principle strategy of the UNF government was to mobilize the support of these actors. In this regard, they were largely successful as the agenda and interests of donors coincided with the UNF’s strategy. In this way, the donor community supported the UNF strategy politically as well as by providing development assistance, without any concern for supporting the LTNP’s strategic objectives or providing development assistance, without any concern for supporting the LTNP’s strategic objectives or providing development assistance, without any concern for supporting the LTNP’s strategic objectives. The paper argues that the politics of donor countries and multilateral organizations contributed to this process.

In April 2004, the economic reform program undertaken by the government led to the breakdown of the peace process. The process, begun with the agreement of the LTNP in 1993, was designed to bring about peace in the conflict. The LTNP signed the agreement to receive international assistance, and the government agreed to carry out various economic reforms. The process was initially successful, with the economy growing at about 1.6% per cent per annum in 1995, suggesting that the peace process was contributing to economic growth. However, the process began to break down after 1995, as the LTNP began to question the government’s commitment to the peace process. The government’s failure to implement the economic reforms led to the breakdown of the peace process.

The study begins with a brief survey of literature on the relationship between liberal capitalism and ethnic conflict. The study begins with a brief survey of literature on the relationship between liberal capitalism and ethnic conflict.

Liberal Capitalism and Ethnic Conflict

The study begins with a brief survey of literature on the relationship between liberal capitalism and ethnic conflict. The studies can be divided into two groups. In the first group are studies that have been less critical of liberal capitalism. For them, the war was merely a barrier for further expansion of capitalism. Hence, they have been critical of where to begin to bring about peace. In this study, the political agenda of these studies has been to bring about peace so that the expansion of liberal capitalism can continue.

The second group of studies have been critical of liberal capitalism. They have been critical of the economic reform program undertaken by the government. The government has been criticized for supporting the LTNP’s strategic objectives without any concern for the economic reform program. The government’s failure to implement the economic reforms led to the breakdown of the peace process.

In conclusion, the study argues that the politics of donor countries and multilateral organizations contributed to the breakdown of the peace process. The government’s failure to implement the economic reforms led to the breakdown of the peace process.
The Economic Agenda and the Peace Process

Essays written after the July 1983 violence, Gunasinghe saw the shift in the relationship between the state and various Sinhalese social groups as a result of the inauguration of liberalized policies in 1977. He also wrote that it was a contributing factor to that violence. The argument is that economic reform is not just a technical issue but involves shifts in the existing relationships between the state and different social groups. This generates its own politics, which will have an impact on the many other areas of society. This study utilizes Gunasinghe's framework to analyze the strategy of the UNF government elected in 2002.

THE CONTEXT OF THE UNF ELECTORAL VICTORY

The first two years of the new millennium saw the coming together of a number of factors that deepened the crisis faced by the fragmented post-colonial Sri Lankan state. These factors included the status of the war, the economy, and stability of elected regimes. There was no end in sight for the two-decade-old war. After the collapse of negotiations between the People’s Alliance (PA) government elected in 1994 and the LTTE, the war was fought at its greatest intensity. A high point of the government's operation was dislodging the LTTE from the Jaffna peninsula. However, 2000 saw a reversal of fortunes on the battlefront. The most significant event was the capture of Elephant Pass by the LTTE in April 2000. This was followed by a well-planned attack on Katunayake international airport in July 2001, which had a significant impact on the economy.

The years 2000 and 2001 were marked by several factors that undermined the economy. The ongoing war, escalating oil prices in 2000, a severe drought and negative conditions in the global economy all had an impact on the Sri Lankan economy. As a result, 2001 has gone down in modern Sri Lankan economic history as the only year when the country recorded negative economic growth.

The third factor was the instability of coalition regimes—the hallmark of the regimes elected under the PA system of elections. Under the PA system, governments with huge majorities dominated by the two major parties were no longer, and coalition governments became the norm. The PA government elected in October 2000 did not last a year after the defection of several key ministers and its main coalition partner, the Sri Lanka Muslim Congress (SLMC). As a result, new parliamentary elections were held in December 2001. After the election, the UNF government was able to form a government that was not dependent on the PA.

In the 2001 election campaign, both the war and the status of the economy figured prominently. The UNF campaigned for starting direct negotiations with the LTTE. It argued that this was necessary to revive the economy, which had received a battering under the PA's rule. Economic factors played a significant role in the UNF's victory in December 2001. A poll prior to the election showed that 84% of voters believed that the PA's performance on the economy was not satisfactory. The UNF strategy consisted of three elements: a ceasefire agreement with the LTTE; an extensive program of economic liberalization; and the mobilization of international support for the peace process.

The UNF strategy

To manage the economy, the UNF government entered into a number of economic reforms in the first year of its government. The ceasefire agreement with the LTTE was signed in February 2002. This agreement allowed the government to freeze control of territory by the LTTE at the point of signing the agreement. The government was able to focus on economic reforms, which included reducing inflation, improving foreign investment, and stabilizing the currency. Economic reforms were also accompanied by a number of political reforms, including the introduction of a presidential system and the establishment of a new parliament. The UNF government was able to implement these reforms successfully, which contributed to its victory in the 2005 general election.
cadres to engage in political work in government controlled areas; and stipulated conditions for withdrawing from the agreement. Hitherto no government had agreed to such provisions. Although the LTTE later withdrew from negotiations in April 2003 (citing their exclusion from a U.S. government-sponsored meeting in Washington), the signing of the CFA created an atmosphere of stability that allowed the UNF to proceed with its economic reform program immediately.

The second element of the UNF strategy was an ambitious program of economic liberalization. The agenda included a mix of stabilization and structural reforms. Stabilization efforts were aimed at curtailing government expenditure. The goals of structural reforms were to reduce the size of public administration; privatize and restructure a number of state-owned enterprises; reform labor laws and introduce institutional reforms in the area of land so that market mechanisms could operate. This was attempted without any significant proposals that would appeal to the mass of the population, which was reeling from the impact of an economic crisis. This program of economic reforms was bound to face political difficulties since it challenged the interests of a range of social classes. However, the UNF leadership pushed ahead with these politically difficult reforms, while also initiating the even more politically ambitious and complex process of negotiations with the LTTE.

The fundamental flaw in the UNF economic strategy was that it did not have a vision that linked it to the peace process. It was an attempt to take economic reforms forward as if applying a blueprint without taking into account the political context and the need for a social base for the peace process.

The third element of the UNF strategy was to mobilize international support for the economic agenda as well as the peace process. For a model case for the peace process, let us examine the example of the political context and the need for withdrawal of economic reforms toward an application of a blueprint without consideration of the political context. The UNF strategy was much more successful in the UNF’s attempt to promote international support for the economic agenda as well as the peace process.

Although the LTTE was not successful in withdrawing from the peace process, without the LTTE’s participation, the UNF’s economic reforms were not as successful as they had hoped. The key to success was to have a vision that linked the economic reforms to the peace process.
The economic agenda and the peace process

The defeat of the UNF

Defeat of the UNF

The greatest beneficiary of the aid flows was the economic reform agenda. The government also managed to secure important agreements like the Poverty Reduction Growth Facility (PRGF) funds from the International Monetary Fund (IMF) and Poverty Reduction Support Credit (PRSC) funds from the World Bank. These funds were widely seen as an endorsement of the country's economic policies and helped secure further donor assistance and foreign investment.

Strategic interests also influenced donors' support of the UNF. For Japan, the beginning of Sri Lanka's peace process coincided with a new direction in Tokyo's foreign policy. It aimed at utilizing development assistance for political purposes, such as resolving conflicts. The conflicts in Sri Lanka and Aceh, Indonesia were some of the first targets of this new experiment.

As the world's only superpower, U.S. interests in Sri Lanka are tied to its wider global strategic interests. For U.S. policymakers, supporting peace and stability in Sri Lanka fit with larger efforts to foster stability in the South Asia region in the post-9/11 era.

Strategic interests of EU countries in Sri Lanka's conflict are closely related to the asylum issue. In many European countries, asylum has become a major issue in internal politics. Making use of the atmosphere of relative stability created by the peace process, the EU secured an agreement with the government to send back failed asylum seekers. This agreement was particularly important for the peace process, as it provided the UNF with a means to counter its political difficulties.

Implementing its strategy proved politically complicated for the United National Party (UNP). For the first time since the enactment of the 1978 Constitution, the president came from one party, and parliament from another. While President Kumaratunge (elected to the position by the People's Alliance in 1999) held the presidency, the parliament was controlled by the UNF. This meant that the government was unable to implement the policies that would have supported the peace process. The government, therefore, had to rely on the support of the opposition to implement the peace process and the economic reform agenda. This was not an easy task, as the opposition was opposed to the peace process and the economic reform agenda.

Defect of the UNF

In February 2004, just after Independence Day celebrations, the president dissolved parliament and called fresh elections. The only way the UNF could counter these political difficulties was to secure the support of the opposition. The government's ability to implement its policies was therefore crucial for the success of the peace process.

One of the most important factors that contributed to the UNF's defeat was the support of the opposition. The government was unable to secure the support of the opposition, and as a result, was unable to implement its policies. This, in turn, contributed to the UNF's defeat in the 2004 elections.

The UNF's defeat and the reasons behind it provide many lessons for those interested in peace. There are many indicators that a large section of the majority Sinhala population has moved away from its opposition to negotiations with the LTTE. In the early stages of the conflict, a majority of the Sinhalese were supportive of the military effort and the media was unanimous in supporting a military solution. The 1994 election was a turning point in this regard, as it was the first time the winning party campaigned on a platform of negotiations. Since then, negotiations have become a major issue in many European countries, as the government has become a major issue in many countries. The government's ability to implement its policies is therefore crucial for the success of the peace process.
These experiences were historical as they were the first elections since voting began in 1931 that the two major political parties campaigned for reforming the centralized post-colonial state and won. Support for negotiations was maintained right throughout the period of the UNF government. Data generated by the social indicator project of the Centre for Policy Alternatives found that during the negotiations close to 80 percent of the population supported a negotiated settlement— including a large percentage of Sinhalese. This indicates a sizeable shift in the opinion of the majority community away from supporting a military solution to the conflict.

The UNF defeat cannot therefore be explained purely by the dynamics of the peace process. The political fallout of the economic reform program also played a critical role. Every economic reform involves rearranging or reconstituting the relationship between the state and social groups affected by the reform. The electoral defeat of the UNF shows that it was not able to manage its reforms without a backlash from the electorate.

The UNF's reform program alienated many social classes within a short period of time, without offering any benefits in return. But the real problem the UNF faced was its own ideology and the vision that informed those policies. With nothing to offer the population besides an elusive peace dividend or economic trickle down, the UNF soon faced problems in its relationship with the president and a large alienated section of the Sinhala population, whose support was essential for the peace process to succeed. The UNF's defeat in the 2004 elections was as much a statement on the political and social fallout from failed economic reform as it was on the military solution to the crisis.

**Can Donor Countries Have a Different Approach?**

This section focuses on some recommendations that donor countries should consider if they are keen to make a contribution to durable peace in Sri Lanka. Donor countries should consider the following:

- **A durable peace involves more than a deal between the LTTE and the ruling classes.** It involves not only an elite pact that could lead to reforms of the Sri Lankan state, but also a reconstitution of the relationship between rulers and the ruled in which principles of pluralism, democracy, human rights, and social justice are central. The primary actors in this process of transformation are internal political forces. Their task is to find the space and the actors within Sri Lankan society to promote values of democracy, human rights, and social justice.

- **There has to be a greater degree of integration of human rights and social justice.** The LTTE's society to promote values of democracy, human rights, and social justice is crucial. The LTTE's defeat is not just a defeat of the peace process, but a defeat of the values that underpin it. The LTTE's defeat should be seen as a defeat of the values that many donor countries support, including democracy, human rights, and social justice.

In the case of Sri Lanka, rethinking these basic principles of democracy, human rights, and social justice is the only way to break the cycle of violence and conflict. The LTTE's defeat shows that the values that many donor countries support are not enough to build a durable peace. The LTTE's defeat shows that a greater degree of integration of human rights and social justice is necessary.

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The primary actors in this process of transformation are internal political forces. Their task is to find the space and the actors within Sri Lankan society to promote values of democracy, human rights, and social justice.

There has to be a greater degree of integration of the economic reform program and the peace process. The former has to be driven by a broader vision of transforming Sri Lanka's economy, society, and politics. The economic reform program and the peace process must work together to build a durable peace.
support for reform while not undermining support for the peace process; greater focus on the timing and sequence of reforms so that the peace process is not undermined.

Maintaining pressure on the LTTE and the GoSL on issues of democracy, human rights, and pluralism. Those who have interpreted peace within a narrower version of security and development have been happy to appease the LTTE despite its authoritarianism and Tamil chauvinism, while also supporting governments if they carry out economic reforms, regardless of their human rights record. These policies should be questioned.

Broadening the social base for peace in the South should go beyond the private sector and organizations identified under the term civil society to include organizations that have a mass base (such as trade unions, student groups, rural organizations) but remain outside the peace process. However, their support cannot be mobilized if the objective of the economic agenda is to merely benefit the well-off.

The behavior of the United People's Freedom Alliance (UPFA) government shows that it has understood the importance of how the UNP's economic policies alienated various social classes. It quickly implemented several policy measures to address this disaffection, most of which were done in an ad hoc and contradictory manner. This highlights, however, how an unwieldy coalition combined with the tendency of our political class to spend unavailable resources has made the situation even more precarious.

Added to these economic complexities are problems with the peace process. Although groups associated with the president are keen to begin the negotiations process, several obstacles remain. They include: a lack of trust between the LTTE leadership and the GoSL; internal contradictions of the ruling regime; uncertainties in the East; and the LTTE's ideology on state reforms as reflected in the proposals for the Interim Self-Governing Authority (ISGA).

The Economic Agenda and the Peace Process

The Economic Agenda and the Peace Process
This report is a contribution to a broader study entitled, “Aid, Conflict and Peacebuilding in Sri Lanka” (Goodhand and Klem, 2005), which examines the peace process in Sri Lanka with a particular focus on international engagement. This study focuses on the relationship between the economic agenda of the UNF government and the peace process it initiated by signing the February 2002 CFA.

The first part of the study gives a brief survey of literature that has analyzed the relationship between the liberalized phase of capitalism in Sri Lanka and the ethnic conflict. It places this study within a framework of analysis pioneered by the late Newton Gunasinghe in an essay written just after the violence of July 1983. The sections that follow contain the bulk of the analysis. After outlining the historical context in which the UNF government came to power, it analyzes the principal features of the UNF strategy. The role of the donors and the private sector is unpacked within this context. Finally, it concentrates on the political fallout of the economic agenda and how it undermined the UNF electoral base.

**Liberal Capitalism and Ethnic Conflict**

1977 was a turning point both in the direction of economic policies and ethnic relations in Sri Lanka. The victory of the UNP government in the July 1977 elections marked the beginning of liberal capitalism in economic policies. In contrast to state-dominated, inward-looking economic policies that dominated in the past, the new model emphasized the private sector, markets and opening up to the global economy. At the same time, the Tamil United Liberation Front (TULF), representing Sri Lankan Tamils, contested the election on a demand for a separate state. In the 1977 election, the TULF asked for a mandate from Tamil people and won all the seats in the Northern Province. However, despite the election of TULF, the Tamils in the Eastern Province were still dominated by the Sinhala majority in the Eastern Province.

In Sri Lankan social science literature there is a range of studies that have attempted to look at the relationship between the twin phenomena of a liberalized economy and deteriorating relations between the state and Sri Lankan Tamils. These studies have focused on various dimensions of this relationship, make use of different conceptual and theoretical frameworks. As a result, the political agendas behind them have been different.

The sections below will discuss the effects of this relationship in detail.
Much of the writing has been produced recently because of the increasing impact of the war on the economic growth process. Hence there have been a series of studies looking at the economic cost of war. This tradition of writing has brought together proponents of liberal capitalism and promoters of peace. The political agenda of the first group was how to settle the war so that the growth process of liberal capitalism could continue. Promoters of peace tried to make use of economic costs as an argument for peace. Both tried to promote peace with a promise of a peace dividend.

One of the most recent writings falling within this ideological framework saw the absence of a peace dividend as the primary reason for the failure of the 2002-2004 peace process (Kelegama, 2004).

The distinguishing feature of the literature in the second group is its critical outlook of the economic model as a whole. It is also critical of specific policies. These writings argue that the promotion of liberalized economic policies has not been a smooth process. Rather such policies have undermined democratic institutions and generated social contradictions that led to greater violence and instability. Within this, critical tradition studies have focused on different subjects and used different conceptual frameworks to make the link between the economy and conflicts.

One of the earlier traditions of this scholarship was to focus on different areas of Tamil grievances. Before the demand for a separate state became the dominant political slogan, principal Tamil demands focused on several areas of state policy. These were the national language policy, access to state employment, land settlement and education. As a result, several studies have focused on examining these areas of grievances. Often they had the political objective of establishing the fact that Tamils do have grievances in these areas and generating a public debate on these issues with the hope of reforming state policies.3

Tamil grievances on land settlement policies have also been explored from several angles. This area received special attention in the post-1977 period because of the Accelerated Mahaweli Settlement Programme. This was the largest program of its kind ever undertaken by Sri Lanka, involving the construction of five dams and the settlement of thousands of people. It was generously supported by donor countries—especially the United Kingdom, Sweden, Germany, Canada, and the United States. Opposed by donor countries, especially the United Kingdom, Sweden, Germany, Canada, and the United States, the program was perceived by many Tamils as a form of colonization, and their demands focused on several areas of state policy. These were the national language policy, access to state employment, land settlement and education. As a result, several studies have focused on examining these areas of grievances. Often they had the political objective of establishing the fact that Tamils do have grievances in these areas and generating a public debate on these issues with the hope of reforming state policies.4

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focused on the overall impact these policies have on democratic institutions, political violence, and the ethnic conflict. These studies see a direct link between these phenomena, including how the period of liberal capitalism undermined democratic institutions as it did away with elements of the welfare state that existed before. As a result, these social impacts led to violence and political decay (Dunham & Jayasuriya, 1998; Moore, 1990).

Within this critical tradition, some have also looked at the extent to which donors have played a role in contributing to the conflict. Since these economic policies were heavily supported by donors, this is an extremely important question to explore. As we have mentioned before, some of the studies have been critical of the support donors gave to controversial projects, like the Accelerated Mahaweli Programme. Others see the responsibility of donors being much more central in explaining Sri Lanka’s conflict. A recent study by Ronald Herring on this issue argues that the situation is much more complex. Although he agrees that external resource flows were important in supporting the economic model and for maintaining regimes, he does not see either structural adjustment or foreign aid as the cause of the conflict (Herring, 2003).

This paper, focusing on the UNF regime between 2002 and 2004, belongs to the critical tradition of scholarship on liberal capitalism. It does not see the promotion of capitalism as a conflict-free process. Rather, the growth of capitalism involves the establishment of new institutions to promote a market economy. This entails a reconstitution of the relationship between the state and different classes that can lead to conflicts.

The Context of the UNF Electoral Victory

Emphasised the UNP's search for peace, for the defeat of the UNP in April 2004, elections that were deeply embedded in social inequalities. This reconstitution of the relationships between the ruling and the opposition parties altered the economic relations that were already characterized by social contradictions. The UNP's economic policies focused on growth with redistribution, while the UNF undertook a strategy to go into the CFA and begin negotiations in order to use the economic crisis of 2002 to promote the UNP's program. After signing the CFA, the UNF's economic reform program was designed to reconstitute the relationship between the state and social classes. This paper focuses on the changing relationships between the state and different social classes as a result of the economic crisis of 2001. It argues that the economic crisis of 2001 prompted the UNF to go into the CFA and begin negotiations. However, in the aftermath, the economic policies of the UNF were not successful in reconstituting the relationships between the state and different social classes. This paper focuses on the changing relationships between the state and different social classes in the aftermath of the CFA.
These factors included the status of the war, the economy, and the stability of elected regimes. There was no end in sight for the two-decade-old war. In the 1994 elections, the PA, led by Chandrika Bandaranaike Kumaratunge, campaigned on a platform of direct negotiations with the LTTE. After winning the elections, the government immediately opened negotiations, but they were short-lived and did not achieve much. In April 1995, the LTTE broke the ceasefire that had been established. After the collapse of negotiations, Sinhala extremist factions within the PA wanted an all-out war with the LTTE. The government, however, wanted an all-out war with the LTTE. The government launched a military operation code-named “Operation Riviresa,” with the objective of wresting control of the Jaffna peninsula from the LTTE. The operation lasted for about seven weeks and the army moved about a dozen miles and secured Jaffna town. However, 2000 saw a reversal of fortunes on the battlefront. The most significant event was the capture of Elephant Pass in April 2000 by the LTTE. This threatened the lives of thousands of soldiers stationed in the area and led to panicked responses from the government. Indeed, the government was rattled to such an extent that it asked for help from India to evacuate soldiers from the Jaffna peninsula. Despite conducting the war at its highest intensity, the LTTE continued to threaten the lives of soldiers stationed in the area. The government, however, continued to make efforts to negotiate a settlement with the LTTE. The government was under pressure to make constitutional changes to address the concerns of the North-Eastern regions. The principal aim of this exercise was to draft a constitution that gave the North-East a degree of autonomy beyond what was stipulated in the 13th Amendment. This resulted in a long-drawn-out process of constitutional discussions within a parliamentary select committee. The government hoped to present proposals to the parliament in August. However, 2000 saw a reversal of fortunes on the battlefront.
Colombo, Gampaha, Kalutara, Galle, Matara, Hambantota, and Kurunegala. All except Kurunegala and Hambantota represent urbanized coastline or maritime provinces that have borne the brunt of economic changes implemented from the colonial period onwards. This counters the usual image of the JVP being a party with a predominant rural political base.

The new government faced extremely difficult economic conditions right from the start. Much of this was due to economic factors from 2000 that began to surface at the beginning of 2001. Kelegama (2001) noted that there were two economic shocks in 2000 that undermined what otherwise was a favorable economic outlook: “On the domestic front, the ongoing war in the North-East of Sri Lanka escalated in April-May 2000 requiring the government to put the nation on a war footing and jack up the defense budget (an increase from Rs. 48 billion in 1999 to Rs. 80 billion in 2000 - 5.6 percent of GDP). On the external front, the oil prices escalated since June 2000 (from US$19 per barrel in 1999 to US$28 per barrel in 2000) making severe inroads into the nation’s foreign exchange reserves (foreign reserves declined by US$596 million).”

In January 2001, the Central Bank was forced to introduce a “free float” exchange rate system, because it was not able to defend the currency due to dwindling foreign exchange reserves. This step was not adequate. In the following month the government imposed a 40 percent surcharge on all imports except a few essential items. This was followed by more measures to enhance revenue and cut expenditures that were introduced through the first budget of the new government in March 2001 (Ibid). “The culmination of all these events was an IMF-led standby package of US$530 million, which was announced in April 2001.” (Ibid).

The pattern of the JVP’s electoral support seems to be very similar to the support base of parties of the old Left, Lanka Sama Samaja Party and Ceylon Community Party.

Table 1. Selected Economic Indicators

<table>
<thead>
<tr>
<th>Year</th>
<th>GDP (% change)</th>
<th>Budget Deficit (% GDP)</th>
<th>Govt. Debt (% GDP)</th>
<th>External assets (months of same year of imports)</th>
<th>Debt service ratio</th>
<th>CIPD (% GDP)</th>
<th>CIPD (% change)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1999</td>
<td>6.0</td>
<td>-7.5</td>
<td>95.1</td>
<td>5.2</td>
<td>4.3</td>
<td>4.3</td>
<td>15.2</td>
</tr>
<tr>
<td>2000</td>
<td>13.2</td>
<td>-9.9</td>
<td>96.9</td>
<td>3.5</td>
<td>2.5</td>
<td>2.5</td>
<td>14.7</td>
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<tr>
<td>2001</td>
<td>13.2</td>
<td>-10.8</td>
<td>96.9</td>
<td>1.5</td>
<td>2.5</td>
<td>2.5</td>
<td>14.7</td>
</tr>
<tr>
<td>2002</td>
<td>2001</td>
<td>6.0</td>
<td>103.2</td>
<td>4.9</td>
<td>4.3</td>
<td>4.3</td>
<td>14.7</td>
</tr>
</tbody>
</table>

It was in this context of economic crisis that the PA government accepted an offer by the Norwegian government to play the role of ‘facilitator’ in opening negotiations with the LTTE. Subsequent events showed that it was a step that the government took reluctantly, primarily because of the economic crisis. As a result, the government regularly insisted Norway’s role was that of “facilitator” and nothing more.

Nevertheless, this was a significant step in the involvement of external actors in Sri Lanka’s internal issues, especially in the area of ethnic politics. Up until Norway’s entrance, it was India that had been the key external player in this arena. There are a lot of reasons for this, including geographical proximity, historical links, India’s role as a regional power, the presence of a Tamil-speaking population in Tamil Nadu, and India’s concerns about the impact of Sri Lankan conflict on her own security.

Before the relationship between the Sri Lankan state and Sri Lankan Tamils deteriorated, India’s main concern was the fate of the Indian Tamil population. A large section of this population lost their Sri Lankan citizenship in 1949 and therefore technically remained Indian citizens. Discussions to resolve this issue were held throughout the post-Independence period under the leadership of various prime ministers from the two countries. A settlement of this issue was finally reached through two agreements signed in 1964 and 1974. With the deterioration of the relationship between Sri Lankan Tamils and the Sri Lankan state, India’s role in Sri Lankan affairs took a qualitatively new turn. Ever since Sri Lankan Tamils demanded a separate state through the Vadukkodai resolution in 1974, India has been making formal and informal representations to the political leadership in Colombo to find a political solution to the Tamil question. India has applied political pressure on the Sri Lankan government to reform the Sri Lankan state to give autonomy to the North-East and used diplomacy to lobby against Sri Lankan involvement in international fora.

In order to reform the Sri Lankan state, which is the stated objective of the current peace process, India began to intervene immediately after Black July. Initially this intervention took the form of an agreement between President Jayawardena and the special representative of then Indian Prime Minister Indira Ghandi. When this did not work, India convened a series of negotiations between the GoSL and Tamil representatives. Finally, it took a direct role in the process by thrashing out a provincial autonomy arrangement for Sri Lanka and sending over 70,000 troops to disarm the militants. The accord that the two countries signed in 1987 was widely considered to be a significant step in the reform of the Sri Lankan state.

By inviting Norway to play the role of a facilitator, the Sri Lankan ruling class moved away from the historically established and Indocentric trend that usually governed external involvement in such issues. What is more, with the subsequent signing of the CFA, the Sri Lankan political class accepted that part of the country would be under the control of an organization whose leader is a convicted criminal in the eyes of the Indian establishment, and a security threat as far as the current leadership of Tamil Nadu is concerned. These are precisely the underlying reasons why India is being kept informed of what is happening in the peace process. But this is a qualitative change from the previous involvement of India in the peace process. Prior to the CFA, the Indian government was more directly involved in the peace process, playing a more active role in the negotiations. Following the failure of the Black July plan in 1983, India assumed a much more direct interventionist role in the peace process, often using the United Nations special representative in Sri Lanka as a mediator. India has also been involved in indirect ways, such as by providing military assistance to the Sri Lankan government.

In order to reform the Sri Lankan state, which is the stated objective of the current peace process, India began to intervene immediately after Black July. Initially this intervention took the form of an agreement between President Jayawardena and the special representative of then Indian Prime Minister Indira Ghandi. When this did not work, India convened a series of negotiations between the GoSL and Tamil representatives. Finally, it took a direct role in the process by thrashing out a provincial autonomy arrangement for Sri Lanka and sending over 70,000 troops to disarm the militants. The accord that the two countries signed had two parts, one relating to the Tamil question and a second on security and defense issues between Sri Lanka and India.

The Economic Agenda and the Peace Process
configuration. This does not mean that India is out of the political equation, but it must now pursue her interests on a much more crowded street.12

Toward the end of 2001, instability, caused by an escalating war and a deteriorating economic situation, deepened the crisis facing the Sri Lankan state. Relations within the PA-SLMC coalition, already shaky from the election violence, soon deteriorated. In addition there was dissent from within the governing party itself. At the center of the controversy were two senior PA ministers. These developments led to the SLMC's departure from government and the defections of some of the members of the PA, including the two ministers. As a result the PA government collapsed within a year and faced fresh elections in December 2001.

These developments demonstrate the third crisis of the Sri Lankan state; the instability of coalition governments that come to power through the country's proportional system of elections. The political outcomes are in direct contrast to the expectations of the architects of the proportional representation (PR) system, who anticipated that it would produce more stable regimes. When PR was introduced in 1978, proponents believed it would produce more stable regimes. When PR was introduced through the 1978 Constitution, proponents expected more stable regimes. When PR was introduced through the 1978 Constitution, proponents expected the system would bring MPs more under the control of political parties. The original PR proposals also had a very high cut-off point for valid votes. The cut-off point was reduced to 5 percent, and MPs could appeal to courts if they were expelled from parties. The result has been unstable coalitions, crossovers, and instability of the governments elected.13

The UNP contested the elections as the UNF because it formed a coalition with the SLMC and the Ceylon Workers Congress. As the data in Table 2 shows, the UNP's performance as the UNF in the 2001 election with 43.2 percent of the total votes polled was the best performance by any party in a national election since 1989. The UNP's performance in 2001 was the best achievement under PR, if we leave out the 1989 election which was held under conditions of extensive violence.14 What is more, the UNP outperformed the PA in the 2001 election with 43.2 percent of the total votes polled. The PA, which had won a majority of the national list seats, was reduced to 25 seats. The UNP, which had won 96 seats, was reduced to 12 seats. The PA's performance in 2001 was the worst performance by any party in a national election since 1989. The PA's performance in 2001 was the worst performance by any party in a national election since 1989. The PA's performance in 2001 was the worst performance by any party in a national election since 1989.

Table 2. Performance of UNP in Proportional Representation Elections

<table>
<thead>
<tr>
<th>Year</th>
<th>% of Valid Votes</th>
<th>Seats Won</th>
<th>Seats from National List</th>
<th>Seats from Electoral Districts</th>
<th>Total Seats</th>
</tr>
</thead>
<tbody>
<tr>
<td>1989</td>
<td>47.6</td>
<td>110</td>
<td>15</td>
<td>125</td>
<td>125</td>
</tr>
<tr>
<td>1994</td>
<td>41.9</td>
<td>81</td>
<td>13</td>
<td>94</td>
<td>94</td>
</tr>
<tr>
<td>2000</td>
<td>38.1</td>
<td>77</td>
<td>12</td>
<td>89</td>
<td>89</td>
</tr>
<tr>
<td>2001</td>
<td>43.2</td>
<td>96</td>
<td>13</td>
<td>109</td>
<td>109</td>
</tr>
<tr>
<td>2004</td>
<td>35.8</td>
<td>71</td>
<td>11</td>
<td>82</td>
<td>82</td>
</tr>
</tbody>
</table>

Source: Computed from data from the Department of Elections, GoSL.
in 17 of the 19 electoral districts where these two major parties could get such majorities. The UNP secured bonus seats in these 17 electoral districts. This was a complete reversal of the result of a year earlier. Another significant outcome of this election was the improved performance of the JVP. Within a year, the JVP had increased its vote from 5.7 percent to 8.6 percent of the total polled, while its number of MPs increased from 10 to 16. It also expanded its representation to 11 electoral districts. Hence its performance just a year prior was not a fluke. It was clear that the JVP, which had entered into politics through an insurrection 30 years before, had become a significant force in parliament. This came after suffering two setbacks when its leadership was decimated through counter-insurgency operations.

During the 2001 election campaign, both the war and the status of the economy figured prominently. The UNF campaigned for starting direct negotiations with the LTTE. It argued this was necessary to revive the economy, as the recession had an impact on all sections of the population. The results of public opinion polls showed that people had more confidence in the UNF's capability to manage the economy than in the LTTE. It argued that the necessary to revive the economy, the LTTE. The results of the economy, Hence economic factors played a significant role in the UNF's victory in December 2001.
By the time the UNF/UNP won the 2001 election, the UNP party was being led by a new generation of leadership whose ideas differed significantly from the Jayawardena/Premadasa era. They had a different outlook toward the war, were supportive of greater liberalization of the economy, and had greater faith in getting the support of external actors in solving Sri Lanka’s problems. Their principal concern was the fate of the economy and how the war was affecting it. They were convinced that a solution had to be found to the civil war in order to put the economy back on track. They seemed to have grasped the fact that Sri Lanka was already firmly linked to structures of global capitalism, and Sri Lanka’s problems, whether economic or political, could only be resolved within these structures.

The 2001 election was the first time that this leadership won an election for the UNP/UNF and had control of parliament. Now they were ready to implement their policies.

Although the long civil war had had a negative impact on the economy, Sri Lanka’s economic growth during these years had been respectable 4-5 percent. Of course it was not the 7-8 percent that the economists kept hoping for, and the absence of war would no doubt have improved this record. Nevertheless, if we focus only on the growth figures, the record has not been bad for a country that has had a civil war running for more than two decades. This relative success is also evident in the increase in per capita incomes. (See Table 3)

The post-war period has seen a significant increase in per capita income, which has helped improve the living standards. The 2001 election was the first time that the UNP/UNF won an election for the UNP/UNF and had control of parliament. Now they were ready to implement their policies.

The election success of 2001 was the first time that the economic growth during the war years had been respectable 4-5 percent. Of course, despite the absence of war, the economy could only be expected to improve with the peace that ended the civil war. The 2000 election was the first time that the UNP/UNF won a number of factors. First, the weaknesses in the UNF/UNP’s campaign were on the economic performance of the UNF/UNP. The UNF/UNP did not address the economic problems adequately, which led to a loss of confidence in the UNF/UNP’s economic policies.

Table 3. Per capita income for selected years

<table>
<thead>
<tr>
<th>Year</th>
<th>GDP (2002)</th>
<th>Per capita income (PPP 1975 Intl$)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990</td>
<td>6.4</td>
<td>942</td>
</tr>
<tr>
<td>1995</td>
<td>5.5</td>
<td>1141</td>
</tr>
<tr>
<td>2000</td>
<td>6.0</td>
<td>1322</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Year</th>
<th>Average annual per capita income (PPP 1975 Intl$)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1999</td>
<td>996</td>
</tr>
<tr>
<td>2000</td>
<td>1095</td>
</tr>
</tbody>
</table>

Table 4. Provincial share of the GDP

<table>
<thead>
<tr>
<th>Province</th>
<th>% Share of the GDP (2000)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Western</td>
<td>49.4</td>
</tr>
<tr>
<td>North-Central</td>
<td>10.4</td>
</tr>
<tr>
<td>Central</td>
<td>9.9</td>
</tr>
<tr>
<td>Southern</td>
<td>9.3</td>
</tr>
<tr>
<td>Sabaragamuwa</td>
<td>6.7</td>
</tr>
<tr>
<td>Eastern</td>
<td>4.5</td>
</tr>
<tr>
<td>Uva</td>
<td>4.0</td>
</tr>
<tr>
<td>North-Central</td>
<td>3.8</td>
</tr>
<tr>
<td>Central</td>
<td>3.0</td>
</tr>
<tr>
<td>Northern</td>
<td>2.1</td>
</tr>
</tbody>
</table>

Table 5. Economic performance 2002

<table>
<thead>
<tr>
<th>Year</th>
<th>GDP (PPP)</th>
<th>Per capita income (PPP 1975 Intl$)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>1996</td>
<td>6.4</td>
</tr>
<tr>
<td>2000</td>
<td>1095</td>
<td>996</td>
</tr>
</tbody>
</table>

Table 5. Per capita income for selected years

The UNF/UNP strategy

2. The UNF Strategy

The UNF/UNP strategy can be attributed to a number of factors. First, the weaknesses in the UNF/UNP’s campaign were on the economic performance of the UNF/UNP. The UNF/UNP did not address the economic problems adequately, which led to a loss of confidence in the UNF/UNP’s economic policies.
A factor to consider is the impact of weather patterns, as the Sri Lankan economy depends to a large extent on rainfall for agriculture (especially its export-oriented plantations) and a supply of energy. A severe drought would affect both these sectors. On the other hand, a favorable climate ensured a better performance of these sectors.

In other words, if Sri Lanka could keep those areas of the country that formed the core of economic activity free from instability, ensure continuous donor support, benefit from a healthy global economy, and be lucky enough to have good weather, the economy would perform reasonably well regardless of a civil war. In 2001, three of these factors went wrong: the attack on Katunayake brought the war into a critical hub of the liberal economy, there was a global economic recession, and the country faced a severe drought.

The UNF strategy to deal with this situation was spelled out by the prime minister in his first policy statement to parliament in January 2002, even before the CFA was signed. The key elements of his statement were in response to the ceasefire already announced by LTTE in December 2001—spurring economic revival and mobilizing international support. The ceasefire agreement and beginning of the negotiation process with the LTTE

The UNF’s negotiation strategy was quite different from ever before. It was when conflict resolution experts described as “step-by-step,” “accelerated,” “definitive,” and “radical” before. The UNF’s negotiation strategy was quite different from ever before. The ceasefire agreement and beginning of the negotiation process with the LTTE

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A total of six rounds of negotiations were held. The most important achievement was an agreement to restructure the Sri Lankan state within a federal framework – an issue announced after the third round of negotiations in December 2002. However, the LTTE withdrew from negotiations in April 2003 citing their exclusion from a U.S. government-sponsored meeting in Washington.17 Apart from the so-called Oslo agreement on federalism, the most tangible achievement of the peace process was the stability it brought to the country. It began right from the moment the CFA was signed. Among the benefits this stability brought was the opening of roads to Jaffna, the removal of checkpoints, and greater movement of the population. As far as the UNF leadership was concerned, it also created an environment that was essential for the revival of the economy.

**ECONOMIC REFORM PROGRAM TO FURTHER THE GROWTH OF A MARKET ECONOMY**

The UNF’s economic reform program was spelled out in a document titled, “Regaining Sri Lanka.” The basic ideology of the strategy was stated very early in the document: “Sri Lanka began to liberalize its economy in 1977. Since then it has made considerable progress. However in recent years that progress has slowed, if not come to a virtual halt, compared to many other countries.”18 The government announced its intention to move the liberalization process forward, with the ultimate objective of achieving 10-percent economic growth. The government had already published its first Economic Stability Program called “Stabilization and Macroeconomic Framework.”

On the structural side the UNF goals were extensive. The legal basis for this fiscal management was to be provided with the introduction of new laws such as the Fiscal Management (Responsibility) Act and the Welfare Benefit Law. The legal basis for the introduction of new laws was to be provided with the introduction of new laws such as the Fiscal Management (Responsibility) Act and the Welfare Benefit Law.

The 2003 Annual Report of the Central Bank of Sri Lanka announced measures to curtail expenditure consisted of “suspending recruitment to the public sector (except for technical and professional grades), avoiding wage and pension increases, reducing and streamlining defense expenditure, better targeting the welfare expenditure, limiting resource allocation for unclassified and unforeseen expenses and controlling the provision of funds for rupee funded capital expenditure.” The legal basis for this fiscal management was to be provided with the introduction of new laws such as the Fiscal Management (Responsibility) Act and the Welfare Benefit Law.

On the structural side the UNF goals were extensive. State-owned assets that were privatized included the Sri Lankan Insurance Corporation, 100 petrol stations belonging to the Ceylon Petroleum Corporation, the trading venture Cooperative Wholesale Establishment, and leases of an oil tank farm. Plans were also drawn up to totally privatize regional transport boards. According to the 2003 Central Bank Report, the government had plans to merge four enterprises, restructure and reform 51 more, and liquidate 15.19 Apart from this, the government took steps to restructure major state-owned institutions like the Ceylon Electricity Board, railways, and airports.

The UNF’s economic reform program was spelled out in a document titled, “Regaining Sri Lanka.”

**GROWTH OF A MARKET ECONOMY**

The UNF’s economic reform program was spelled out in a document titled, “Regaining Sri Lanka.”

Economic reform was essential for the revival of the economy.
under which public sector employment would be reduced by 30 percent during the 2004-2006 period. A voluntary retirement scheme was also to be introduced to reduce the number of employees in several state-owned enterprises. Plans also included not renewing the contracts of public servants between the ages of 55 and 57. It was expected these measures would cut employment by 10 percent.

Another important area of reform was in labor law - in response to major demand from the private sector. Labor laws in operation at the time made it difficult for the private sector to hire and fire workers as they wished or to reorganize the labor process when necessary. As stated in the 2003 Central Bank Report, “major steps were initiated in 2003 to address the long-overdue labor market reforms. Accordingly, amendments were made to the Employment of Women, Young Persons and Children Act.” Finally the government undertook several measures to further liberalize the financial sector.

This program of economic reforms was significant because of the UNF’s attempt to move ahead in several areas that were politically sensitive. In the past, reforms and reduction of the state bureaucracy, privatization, and changing labor laws have met with resistance. The very fact that the UNF wanted to undertake them in the middle of a complex peace process showed that economic revival was as important to the UNF leadership as the peace process. In their minds, both were integrally linked. Judging by what the UNF tried to implement on the economic front within a short period of two years, it is clear that they were well prepared to move forward on the economic reform agenda as soon as the CFA provided stability.

The third element of the UNF strategy was a conscious effort to bring in a wider network of international actors to support both the peace process and the planned economic reforms. The UNF leadership managed to secure the support of the U.S. government and the EU as co-chairs of the peace process. In doing so, the UNF managed to secure United States, Japan and the EU as co-chairs of the peace process in addition to Norway, the government brought in the United States, Japan and the EU as co-chairs of the peace process. In doing so, the UNF managed to secure the support of the U.S. government and the EU as co-chairs of the peace process. In doing so, the UNF managed to secure the support of the U.S. government and the EU as co-chairs of the peace process.
was named as a potential candidate for a Free Trade Agreement with the United States.

As Sri Lanka’s largest bilateral donor, Japan was also a key player. If we take into account its influence on multilateral agencies like the Asian Development Bank (ADB), Japanese assistance is critical for the revival of Sri Lanka’s economy. The UNF managed to secure Japanese involvement in the peace process with the participation of Ambassador Yasushi Akashi.

The third international actor, the EU, has been active in Sri Lanka’s political issues for some time. Apart from regular statements demanding that the conflict be settled through negotiations, the EU has regularly sent election monitoring teams to Sri Lanka. Moreover, EU countries are not only important trading partners, but comprise a significant collection of donors. As a result, it was quite a coup for the UNF to persuade the EU to be one of the co-chairs in the peace process.

The UNF’s internationalization strategy also included India, as doing otherwise would have been foolish. But the significant departure of their strategy was to look at India as an important economic partner as well. While keeping India in the loop about what was going on with the peace process, building economic links with India became the cornerstone of the UNF’s India policy. Both the prime minister and the minister for economic reform took a leading role in propagating this aspect during their numerous visits to India. The basis for this was laid by the Free Trade Agreement signed during the PA regime.

Several other initiatives such as expanding air routes between the two countries, building a road link between Sri Lanka and South India, easing visa restrictions for Indian nationals traveling to Sri Lanka, and the promotion of Indian tourism in Sri Lanka were implemented during this period. A qualitatively new idea that the UNF mooted at this time was looking at India as a potential candidate for a Free Trade Agreement with Japan.

The three elements of the strategy were interlinked. The UNF hoped to establish security and stability in order to further capitalist development in Sri Lanka. The economic crisis of 2001 prompted the ruling class to take unprecedented measures to put the economy back on track. They accepted that part of the territory of Sri Lanka was under the control of the LTTE and entered into the CFA with the LTTE. Finally, international actors were invited to participate at a level never seen before. The UNF leadership hoped to achieve both security and development through this strategy.

The three-pronged strategy of the UNF lasted until April 2003, when the LTTE withdrew from the negotiations because of their exclusion from a U.S.-sponsored meeting in Washington, which took place prior to the Tokyo Conference on Reconstruction and Development of Sri Lanka in November 2002. The LTTE’s withdrawal from the peace process was a significant blow to the UNF’s political prospects. The LTTE’s proposal for an ISGA that was put forward by the LTTE in response to the proposal from the UNF was seen as a serious challenge to the current deadlock of the peace process. The most significant outcome of the peace process was the creation of a political framework to facilitate relief and rehabilitation efforts in the North-East. The three-proposed states of the UNF lasted until the end of the peace process.
led to a breakdown of talks and deprived the economic revival of much-needed time. As stated in the Central Bank Report, “In 2003, Sri Lanka made further progress in its march to economic recovery and stability through a continuation of sound macro-economic policies and further deepening of structural reforms. This was supported by a favorable environment resulting from the confidence built by the continuation of the ceasefire, a gradual improvement in the world economy and increased international support for the country…on the production side, all major sectors, particularly paddy, manufacturing, trade, telecommunication, financial services, tourism, port and aviation, and construction contributed to the acceleration of growth, with a 5.9 percent growth recorded in Gross Domestic Product (GDP) and a 6.4 percent in Gross National Product (GNP).”

The ‘internationalization’ strategy also contributed to the economic agenda by generating a significant amount of external assistance for the economic revival and sending the correct signals to investors. Positive developments in the global economy also played their part. Hence the most important contribution of ‘internationalization’ was in the economic sphere. On the other hand, the impact of the internationalization strategy was contradictory in relation to the success of negotiations. Unlike other liberation organizations based on nationalist ideologies, the LTTE’s political strategy did not preclude it from mobilizing support among Western societies and governments. The presence of a significant Tamil community in these societies made such a strategy relevant. This need became even more important after the LTTE had to totally abandon any hope of a support base in India. However, by the time negotiations began the LTTE was a banned organization in several Western countries. The primary reason for this was the security concerns of these countries, particularly in the post-9/11 world. The LTTE was a dynamic organization in recession, but as the ceasefire began, the LTTE had to come to the conclusion that it was no longer viable to continue with the same operations. The LTTE’s political goal was to establish a separate state for the Tamil community in those areas, and in order to achieve this, the LTTE needed more international support and recognition. The presence of a significant Tamil

...
being a political organization with an acute sense of where power lies, the LTTE will continue this strategy carefully, identifying where and with whom it can achieve the most benefit. Nevertheless the LTTE, being a hardcore nationalist organization, will always be wary of leaving the fate of the Tamil polity to international forces (Uyangoda, 2004).

The experience also showed the limits to which international actors could influence the negotiation process. International pressure was not effective once the peace process began to go wrong. The much-publicized Tokyo conference, without the participation of the LTTE, symbolized this fact. No amount of statements or pressures from these actors could persuade the LTTE to participate in this conference. Neither could they do much once the cohabitation arrangement began to unravel. Although there were many meetings, statements, and pressures that were not made public, it did not prevent the president from first taking over ministries and then dissolving the government and calling for elections.

The other failure during these two-and-a-half years was the fact that there was very little movement in new initiatives to improve the living conditions of people in the North-East. It is not that nothing happened. Once the conditions of stability returned, people themselves began to get back to their economic activities. Some donors managed to start new initiatives. But the big peace dividend that was promised did not materialize. All discussions about substantial new investments with donors and international non-governmental organizations (NGOs) and conflict resolution experts also failed to materialize. In fact, the LTTE was more successful in getting funds from international donors than the government was.

The biggest failure of the UNF strategy was their defeat in the 2004 elections. It was this defeat that marked the end of the UNF strategy. How did this happen? In the last section of this report we shall turn to these issues in detail and try to understand why the LTTE was able to defeat the UNF strategy.

ROLE OF BIG BUSINESS

An interesting development that took place during the period covered by this study is the intervention for peace by the representatives of big business. In 1977, when the Jayawardena regime ushered in the liberalized phase of capitalism, the TULF fought the election on a separatist platform. From this moment it was clear to students of the political economy of Sri Lankan capitalism that the ruling political class had to resolve the ethnic conflict in order to further capitalist growth in Sri Lanka. But instead what we saw was a deterioration of the situation that ultimately dragged the country into an expensive war.

A frequent question among academics and researchers witnessing this deteriorating condition was: "Where are the rational capitalists?" Behind this debate was the puzzle: why were the capitalist classes, whose long-term interests were undermined by this war, not bringing pressure on the ruling regimes to force a settlement to the conflict? Why were they letting various governments drag the country into an unwinnable war that was detrimental to the long-term interests of capitalists? Available knowledge provides three possible answers. First, contrary to the notion that "rational capitalists" are driven purely by rational economic calculations, some of the business interests were supporters of Sinhala Buddhist nationalism. Hence, rather than being promoters of peace, they were supporters of war. Some of the business interests were supporters of Sinhala Buddhist nationalism. Hence, rather than being promoters of peace, they were supporters of war.

The other failure during these two-and-a-half years was the defeat of the UNF strategy in the 2004 elections. How did this happen? In the last section of this report we shall turn to these issues in detail and try to understand why the LTTE was able to defeat the UNF strategy.
The late 19th century revival of Sinhala Buddhist nationalism was supported by a class that accumulated wealth during the colonial period. These were families that benefited from the economic opportunities opened up during the colonial period. They strongly supported Sinhala Buddhist nationalism ideologically, as well as materially, by among other things setting up new organizations, schools, and charitable organizations. Their political project included opposing colonialism as well as the influence of Christian missionaries. This is an ideological current that still dominates within the business community. Therefore, even in recent times there are significant sectors of the business community involved in supporting extreme Sinhala groups.25

Second, those capitalist actors who were not imbued with Sinhala Buddhist nationalism lacked the political clout to influence the political process. With the growth of capitalism, business actors began to dominate in the economy, however, it does not always mean that they dominated politics. In the context of an electoral process based on universal franchise (as in Sri Lanka), business interests are only one of many interests that influence political process. Often they are a less influential factor than other social groups. Hence business leaders could not always have their own way when it came to politics. Their political project included opposing colonialism, material, by among other things setting up new organizations, schools, and charitable organizations. Their political project included opposing colonialism, as well as the influence of Christian missionaries. This is an ideological current that still dominates within the business community. Therefore, even in recent times there are significant sectors of the business community involved in supporting extreme Sinhala groups.25

Third, until the PA regime began to wage the war at its highest intensity, the conflict did not have a significant impact on the accumulation process of the fairly sizeable bourgeoisie. The 1977 liberalization of the economy opened up many new avenues of accumulation for the bourgeoisie. The 1977 liberalization of the economy opened up many new avenues of accumulation for the bourgeoisie. It is in the context of this economic debacle and undermining of the interests of the bourgeoisie that we see the first emergence of an organized expression by the business classes for peace and a negotiated settlement. It is not that there were no calls for peace among the business community before, but that their position is not that there were no calls for peace among the business community before, but that their position.
differed in several ways. First, there was a strong representation of business organizations representing the interests of sectors that emerged in the post-1977 period. Second, representatives of some of the larger business houses began to play a prominent role in the peace process. Third, this intervention seemed to be much more organized and institutionalized than before when efforts were ad hoc and based on individuals. In short, big business intervened in the politics of a negotiated settlement as a class.

If we identify the principal actors behind these initiatives, four prominent groups stand out. These are: the group around the initiative called Sri Lanka First; activities of prominent businessman Lalith Kotelawala; various chambers of commerce; and the Joint Business Forum. The constituent members of the Joint Business Forum include: Ceylon Chamber of Commerce, International Chamber of Commerce Sri Lanka, National Chamber of Commerce, Employer's Federation of Ceylon, Exporters Association of Sri Lanka, Sri Lanka Bank's Association, Federation of Chambers of Commerce and Industry of Sri Lanka, and National Chamber of Exporters. It is also important to note that spearheading some of these activities were personalities linked to the elite families of Sri Lanka. This would have had its own impact in getting these interventions off the ground.

Donor support was one of the important factors in strengthening the role of the private sector in peace. By the time these activities emerged, most donors, including those who earlier supported much more social-oriented programs like rural development, shifted their policies to focus on two areas: conflict resolution and private sector development. As a result, strengthening the role of the private sector in peace became a logical development to the donors' new orientation. Indeed, some of the business initiatives for peace were supported by donors.

The peace campaign of organized business played a prominent role during the 2001 general elections. Although they did not ask people to vote for a particular party, their campaign for negotiations was an indication of support for the UNP. This support would have been supplemented with more tangible material assistance, if not access to the president and the UNP. The Joint Business Forum played a significant role in this effort. The Joint Business Forum played a significant role in mobilizing the support of the private sector for the UNP government. However, these efforts did not succeed in reversing the momentum of the SLFP and gaining access for the business community to the government's decision-making process.

When the post-2001 arrangements were threatened to break down, some sections of the private sector made a special effort to rescue the situation. This was particularly noticeable when the cohabitation arrangements between the president and the UNP government began to unravel. Private-sector groups made several efforts to halt the deterioration of this relationship. The Joint Business Forum played a prominent role in this regard. Some business personalities even attempted to mobilize the support of the Mahanayakes of the Siam and Asgiri sects for this purpose. However, these efforts did not succeed in ensuring the survival of the UNP government and demonstrated the limited role of the business community in the politics of the UNP government and its survival.
Sri Lanka has been generously supported by donors since the economy was liberalized in 1977. The primary reason for the multi-fold increase in aid flows was the opening up of the economy in 1977. This received endorsement and support from key multilaterals like the IMF and the World Bank. Donor support has been important in financing budget deficits, overcoming balance of payments problems, financing public investment programs, and rescuing the economy when it was in trouble.

As we have mentioned in an earlier section, this is precisely what happened when the IMF introduced a rescue package in 2001 when the economy was in trouble. The principal reasons behind this crisis were large-scale purchases of arms after the fall of Elephant Pass and the increase in the price of oil. The economic recession of 2001 signaled the fact that the economic agenda started in 1977 (and supported by donors) had been undermined. Now the UNF government was promising to put things right by initiating the peace process and carrying out key economic reforms.

Although there were differences among donor countries, these differences should not be considered to be the result of a lack of donors' interest in the Sri Lankan economy. All donor countries believed that the promotion of a liberal market economy, and strengthening liberal institutions and values, was the way forward for peace and prosperity in Sri Lanka. In order to promote this agenda, it was necessary to promote a deal between the LTTE and the government of Sri Lanka. Therefore, there were mutual interests in promoting the peace process. However, there were many indications that the peace process was in trouble. The government's policy of internationalization had the effect of undermining the peace process. The LTTE's position was that a negotiated settlement was needed. However, India's position was different. India was a key player in the conflict.

The position of India was important because India was a key player in the conflict. India's position was different from that of the LTTE. India was more willing to negotiate a settlement with the LTTE. The LTTE was more willing to negotiate a settlement with the government. However, there were many indications that the peace process was in trouble. The government's policy of internationalization had the effect of undermining the peace process. The LTTE's position was that a negotiated settlement was needed. India's position was different. India was a key player in the conflict. India's position was important because India was a key player in the conflict.

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The major deviation within the broad agreement among donors was the U.S. position in relation to the LTTE. The United States stood out with its skepticism about the seriousness of the LTTE in pursuing a negotiated settlement. The general U.S. attitude toward the LTTE reflected the opinion that was applied strictly not only to the dealings of U.S. government organizations like USAID, but with regard to the use of any public funds by others. On several occasions, U.S. spokesmen emphasized that the LTTE had to demonstrate through concrete action that they had given up terrorism in order to get recognition from the United States.

Despite this skepticism about the LTTE, the United States did not deviate significantly from the position of other donor countries. For example, it did not seek to translate its skepticism about the LTTE into increased military support to Sri Lanka. Instead the United States sought to apply conditions based on liberal principles more systematically to the LTTE—including in the declaration of the Tokyo conference. The final part of the declaration, entitled, “Linkage between Donor Support and Progress in the Peace Process,” had several clauses that related to the LTTE. Among them were ones that related to the participation of a Muslim delegation in negotiations, the Oslo Declaration, adhering to human rights norms, the issue of child soldiers, and demilitarization.

The U.S. position received support from independent civil society activists with many of them supporting the peace process while also seeking to strengthen human rights mechanisms. The attempt to find a role for an independent human rights expert was significant in this regard. This process has continued at the international level even after the breakdown of the peace process. The best examples are the recent activities of Amnesty International and Human Rights Watch that have succeeded in taking the issue of child soldiers to the UN Security Council.30

In contrast to the United States, there were several donor countries that took a more open attitude toward the LTTE. They did not see pressing issues such as human rights as such a priority and were more concerned with extending their activities to the North-East. They were also ready to accept the LTTE’s position of being the sole representative of Tamils. The point of debate among them was how to apply the conditionalities of the Tokyo Declaration, which they often regarded needed to be applied equally to both the government and the LTTE.

Nevertheless, just as U.S. attitudes toward the LTTE did not result in any significant increase in military support to Sri Lanka, the attitude of those who wanted a more balanced approach likewise did not result in significant pressures on the GoSL. In other words, these differences within donor countries were not so great as to bring about serious differences with the LTTE. They were ready to engage with the LTTE directly, did not see pressing issues such as human rights as such a priority, and were much more concerned with extending their activities to the North-East. They were also ready to accept the LTTE’s position of being the sole representative of Tamils. The point of debate among them was how to apply the conditionalities of the Tokyo Declaration, which they often regarded needed to be applied equally to both the government and the LTTE.
These aid flows supported the UNF government in its management of the economy, especially in deficit financing. The utilization of foreign sources of finances to cover the budget deficit increased from 0.5 percent GDP in 2002 to 2.9 percent GDP in 2003—an amount larger than was estimated in the 2003 budget.32

The utilization ratio of foreign assistance also improved. It increased to 21 percent in 2003, compared to 13 percent in 2001 and 15 percent in 2002. This was partly because the prime minister took a personal interest in improving aid utilization by bringing the External Resources Department, responsible for aid agreements and negotiations with donors, under the jurisdiction of his office. He also created a special committee to oversee the mobilization and utilization of aid.

The increased flow of aid also helped to adjust the balance between loans and grants. The proportion of grants in the aid flows increased from 33.8 percent in 2000 to 41.2 percent in 2003. Correspondingly, the proportion of loans decreased from 66.2 percent to 58.6 percent for the same period.

This generous support, however, did not improve the foreign debt burden of Sri Lanka. Between 2000 and 2003, the outstanding stock of foreign debt increased from 43.1 percent to 47.9 percent of GDP. According to the 2003 Annual Report by the Central Bank of Sri Lanka, 50 percent of this increase was due to depreciation of the rupee. This high level of foreign debt also meant that despite increased donor support, there were some cases where there was a net outflow of donor funds. The table below provides data for those donors where there was a net outflow of the aid flows in favor of Sri Lanka.

The utilization ratio of foreign assistance also improved. If increased to 21 percent in 2001 and 15 percent in 2002, the increased flow of aid also helped to adjust the balance between loans and grants. The proportion of grants in the aid flows increased from 33.8 percent in 2000 to 41.2 percent in 2003. Correspondingly, the proportion of loans decreased from 66.2 percent to 58.6 percent for the same period.

The budget for 2003 indicated that was estimated in the 2003 budget. To cover the budget deficit, the aid flows increased from 0.5 percent to 2.9 percent in 2003. Correspondingly, the proportion of loans decreased from 66.2 percent to 58.6 percent for the same period.

<table>
<thead>
<tr>
<th>Year</th>
<th>Loans (in Rs.million)</th>
<th>Grants (in Rs.million)</th>
<th>Total (in Rs.million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>1000</td>
<td>1500</td>
<td>2500</td>
</tr>
<tr>
<td>2001</td>
<td>1200</td>
<td>1300</td>
<td>2500</td>
</tr>
<tr>
<td>2002</td>
<td>1400</td>
<td>1400</td>
<td>2800</td>
</tr>
</tbody>
</table>

Source: Annual Reports of the Central Bank, 2000-2003
This is not to argue that donors were not interested in expanding their work in the North-East. The 15 new projects mentioned above show donors were keen to expand in these areas affected by war, but large-scale support to the North-East did not materialize because of the failure of the peace process. Indeed, the highly publicized $4.5 billion committed at the Tokyo donor conference included funds for the economic reform program, funds for development of the South, and new money for the North-East. The government could begin to utilize the funds for the first two categories right away, but the bulk of the funds for the North-East got trapped in the politics of the peace process. Therefore the greatest beneficiary of the aid flows was the economic agenda. The government secured funds to improve the macroeconomic fundamentals and specific development projects. It also managed to secure important agreements like the PRGF funds from the IMF and PRSC funds from the World Bank. As stated in the Central Bank’s 2003 Annual Report, these approvals were an endorsement of the country’s economic policies and helped secure concessional assuredness from other donors and international financial institutions.

Table 6. Donors with a net positive flow of foreign aid to Sri Lanka

<table>
<thead>
<tr>
<th>Country</th>
<th>2000%</th>
<th>2001%</th>
<th>2002%</th>
<th>2003%</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>ADB</td>
<td>47.6%</td>
<td>25.0%</td>
<td>26.9%</td>
<td>41.6%</td>
<td>2236%</td>
</tr>
<tr>
<td>Australia</td>
<td>257%</td>
<td>1.3%</td>
<td>1.4%</td>
<td>0.3%</td>
<td>1.2%</td>
</tr>
<tr>
<td>Austria</td>
<td>33.7%</td>
<td>1.0%</td>
<td>0.1%</td>
<td>5.2%</td>
<td>5.0%</td>
</tr>
<tr>
<td>Belgium</td>
<td>8.9%</td>
<td>0.1%</td>
<td>0.0%</td>
<td>4.4%</td>
<td>4.4%</td>
</tr>
<tr>
<td>Canada</td>
<td>8.9%</td>
<td>0.1%</td>
<td>0.0%</td>
<td>4.4%</td>
<td>4.4%</td>
</tr>
<tr>
<td>China</td>
<td>101.7%</td>
<td>53.4%</td>
<td>56.6%</td>
<td>56.6%</td>
<td>121.4%</td>
</tr>
<tr>
<td>Denmark</td>
<td>325%</td>
<td>1.7%</td>
<td>1.4%</td>
<td>1.4%</td>
<td>1.6%</td>
</tr>
<tr>
<td>Germany</td>
<td>839%</td>
<td>4.4%</td>
<td>0.7%</td>
<td>1.0%</td>
<td>3.9%</td>
</tr>
<tr>
<td>Greece</td>
<td>241%</td>
<td>1.3%</td>
<td>1.7%</td>
<td>0.3%</td>
<td>3.2%</td>
</tr>
<tr>
<td>Holland</td>
<td>42.7%</td>
<td>2.0%</td>
<td>6.2%</td>
<td>5.3%</td>
<td>12.7%</td>
</tr>
<tr>
<td>India</td>
<td>242%</td>
<td>1.1%</td>
<td>1.7%</td>
<td>0.3%</td>
<td>3.7%</td>
</tr>
<tr>
<td>Italy</td>
<td>282%</td>
<td>1.1%</td>
<td>0.2%</td>
<td>0.0%</td>
<td>1.4%</td>
</tr>
<tr>
<td>Japan</td>
<td>33.4%</td>
<td>3.4%</td>
<td>4.4%</td>
<td>4.4%</td>
<td>11.7%</td>
</tr>
<tr>
<td>Netherlands</td>
<td>5.1%</td>
<td>5.1%</td>
<td>0.1%</td>
<td>0.0%</td>
<td>0.4%</td>
</tr>
<tr>
<td>Norway</td>
<td>325%</td>
<td>1.7%</td>
<td>1.4%</td>
<td>1.4%</td>
<td>1.6%</td>
</tr>
<tr>
<td>Pakistan</td>
<td>247%</td>
<td>2.7%</td>
<td>0.2%</td>
<td>0.2%</td>
<td>3.2%</td>
</tr>
<tr>
<td>Sweden</td>
<td>381%</td>
<td>1.3%</td>
<td>1.3%</td>
<td>0.0%</td>
<td>2.7%</td>
</tr>
<tr>
<td>Switzerland</td>
<td>191%</td>
<td>0.7%</td>
<td>0.2%</td>
<td>0.0%</td>
<td>1.0%</td>
</tr>
<tr>
<td>Total</td>
<td>100.0%</td>
<td>100.0%</td>
<td>100.0%</td>
<td>100.0%</td>
<td>100.0%</td>
</tr>
</tbody>
</table>


The Economic Agenda and the Peace Process
The executive summary of the "Country Strategy for 2003-2006" stated that, on the political front, a private-sector oriented government led by Prime Minister Ranil Wickremasinghe has "assumed control and has moved decisively in starting to implement a comprehensive reform program." The bank and other multilateral agencies were ready to help the government to take this mission forward.

In the case of Japan, the beginning of Sri Lanka's peace process coincided with a new direction in Tokyo's foreign policy. For many years Japan has been one of the largest aid donors globally, and, in keeping with a policy of promoting Japanese interests through aid, the focus had been on linking aid with trade. The new direction sought to change this emphasis. It aimed at utilizing development assistance for political purposes, such as resolving conflicts, and this new direction was to be tried out in Asia where Japan had a greater degree of experience and interest. The conflicts in Sri Lanka and Aceh were to be some of the first targets of this new experiment. This explains why Japan appointed a high-powered representative to deal with Sri Lanka, agreed to be a co-chair of the peace process, committed more resources, and hosted the Tokyo conference.

U.S. interests in Sri Lanka's affairs stem from its role as the only superpower that has global strategic interests. More specifically, in the post-9/11 period, stability of the South Asia region became increasingly important for U.S. policymakers. Despite its skepticism about the LTTE's genuineness in a negotiated settlement, the U.S. has consistently advocated negotiations in order to resolve Sri Lanka's conflict. In addition, the United States is also an important trading partner for Sri Lanka. U.S. foreign policy objectives and an expansion of U.S. development aid post-9/11, rendered Sri Lanka a willing partner for U.S. foreign policy objectives.

The strategic interests of EU countries in Sri Lanka's conflict are closely related to the asylum issue, a major topic of contention in the internal politics of many member states. This has been especially true during election campaigns or instances when right-wing groups have sought to challenge (sometimes violently) immigration policies that granted asylum to refugees. In the aftermath of 9/11, it has also become a security issue, and for some time European countries have been seeking a formal agreement with Sri Lanka in order to regulate the return flow of refugees. In January 1994, Switzerland became the first country to secure an agreement. The peace process created conditions for a much wider agreement. Indeed one of the major achievements of the EU during the peace process was to secure a common agreement applicable to all member countries. The peace process created conditions for a more inclusive agreement, albeit one that, in the words of the EU, did not "secure an asylum status in Europe. While some have received the right to settle in these countries, many others have been denied protection. Indeed, one of the major achievements of the EU during the peace process was to secure a common agreement applicable to all member countries. This took place during the visit of the Norwegian foreign minister to Brussels in July 2002.
The politics of successfully implementing the UNF strategy depended on two factors: managing the relationship with President Kumaratunge (who was elected in 1999 from the PA) and sustaining the support of the southern electorate (which had put the UNF into power in 2001).

Given that the rivalry and antagonism between the PA and the UNP went back almost to the beginning of the post-Independence period, the so-called cohabitation exercise by the two parties experienced difficulties right from the beginning. Although there were many efforts to continue with this arrangement, factionalism within the political class based on personal and family rivalries made it extremely difficult to sustain. Cohabitation between the president and the UNF government barely lasted two years. The president took over three critical ministries in November 2003, signifying the beginning of the end of the cohabitation. In February 2004, just after Independence Day celebrations, the president dissolved parliament and called for fresh elections.

The only way the UNF could counter these political difficulties was by maintaining the support of the southern electorate. If the UNF had won the 2004 elections, the entire strategy of peace efforts and economic reforms would have been strengthened and advanced. The electorate would have endorsed the international support that the UNF had sought out and received. But this was not to be. The UNF was soundly defeated in the 2004 elections. The reasons behind this defeat provide many lessons for those interested in peace.

There are many indicators that show that a large section of the majority Sinhala population has moved away from its opposition to negotiations with the LTTE. In the early stages of the conflict, a majority of the Sinhalese were supportive of the military option. As usual, the media was unanimous in supporting a military solution, and the elections of the same year saw the two main parties (the UNP and the LTTE) contest the elections together. For many Sinhalese, including the president, the negotiated settlement was a necessity for a return to peace.

Support for negotiations was maintained throughout the period of the UNF government. As shown by data generated by the Social Indicator project of the Centre for Policy Alternatives, during the negotiations close to 80 percent of the population was in support of a negotiated settlement (Centre for Policy Alternatives, 2003). The president was elected in 1999, and the UNF government was in power for a short period of time. Support for negotiations was maintained throughout the period of the UNF government and won.

The 1994 election was a turning point in this regard (since the first election in 1977). When the two major presidential candidates campaigned for a negotiated settlement, the sum of the population’s support for the president and the UNF government was high. This was the period of successful negotiations between the president and the LTTE. After the 1994 elections, the president made efforts to continue with the negotiated settlement, and the LTTE agreed to the beginning of the peace process.

However, the LTTE’s demands were not met, and the elections were held in 1999. The LTTE was dissolved, and the UNF government was voted out of power. The defeat of the UNF was a turning point in this regard, and the LTTE continued its armed struggle.

In conclusion, the defeat of the UNF was a turning point in the political landscape of Sri Lanka. The UNF’s efforts to implement a negotiated settlement were not successful, and the LTTE continued its armed struggle. The reasons behind this defeat provide many lessons for those interested in peace.
The politics of successful reform involves managing the negative fallout peacefully while retaining the support of the population as a whole. The defeat of the UNF in the 2004 elections, however, shows that they were not able to manage their reforms without a backlash from the electorate.

Although the beginning phase of liberal capitalism in Sri Lanka goes back to 1977, the economic reform program has not made progress in several key areas. These include:

- Reform and reduction of the state bureaucracy;
- Restructuring and privatization of some of the remaining state-owned enterprises, especially in the financial sector, power generation, and railways;
- Reforms in labor laws so that the labor market could operate without restrictions; and
- Developing market mechanisms in land and water.

In all of these areas there have been discussions and debates about reforms for a considerable period of time. Indeed, multilateral donors have been demanding them for some time. In some cases, studies and reports have been conducted, discussions with donors held, and even some initial steps taken. But the progress has been slow, often with frequent reversals.

The principal reason for this is the delay in the adoption of market mechanisms in land and water. Reforms of state enterprises have to tackle the resistance of people employed in these enterprises. Salaried employees of the state sector form a part of what some Marxists called the "intermediate class." This class expanded during the period of state-dominated capitalism. In the post-Independence period, intermediate classes have been an important element of the class block that has ruled Sri Lanka. Historically, the bourgeoisie that accumulated wealth during the colonial period inherited power from the colonial masters. This could not be maintained in the context of universal franchise and regular elections. The class that rose up through the electoral process to share power with the colonial bourgeoisie was this intermediate class. Even during the post-1977 period this class has expanded due to the impact of liberal economic policies, as the expansion of various sectors of the economy increased the size of the intermediate economic classes. Even during the post-1977 period this class has expanded due to the impact of liberal economic policies, as the size of the intermediate economic classes increased.

Developing market mechanisms in land and water

- Reform and reduction of the state bureaucracy;
- Restructuring and privatization of some of the remaining state-owned enterprises, especially in the financial sector, power generation, and railways;
- Reforms in labor laws so that the labor market could operate without restrictions; and
- Developing market mechanisms in land and water.

The intermediate classes, even in developed economies of fairly well organized and entrenched interest groups, resistance of fairly well organized and entrenched interest groups, and ideologies, often have to manage the resistance of fairly well organized and entrenched interest groups, resistance of fairly well organized and entrenched interest groups, and ideologies, often in developed economies.
Lankan state. Challenging it and bringing about reforms that would introduce market-oriented reforms in the area of land and water means facing political difficulties not dissimilar to reforming the state to meet the autonomy demands of the Sri Lankan Tamils. Hence the UNF economic strategy—which, among other things, attempted a significant retrenchment of public employees, extensive privatization, reform of labor laws, and the implementation of institutional changes to land policies—actually entrenched several social and political forces simultaneously. This was done while also attempting to bring about a historic transition to the structure of the state through negotiations with an armed group that had been proscribed a few years previously.

Of course, the political difficulties associated with the reform process do not mean the post-1977 ruling classes did not manage to successfully implement some reforms that favored capitalism. Indeed, if we look at the context in which major reforms were done, we can see a situation where the balance of political forces was in favor of the ruling class. Three examples from the past substantiate this:

1. The first came with the 1977 inauguration of liberal capitalism. The UNP could easily carry out a series of reforms because they had just won an election and commanded a five-sixths majority in parliament. The opposition was weak and there was no question of mounting any resistance. In addition, by introducing a powerful presidency—and by rigging a referendum in 1982 that extended the life of the parliament (and the UNP's hold on power) for another five years—the UNP leadership acquired all the power necessary to begin reforms. Thus the Jayawardena era lasted for 12 years and saw a significant amount of institutional change. The economic performance was good and there was stabilization of the economy. The question then becomes: did the UNP have the power to carry out these reforms?

2. The second period of major reforms came under President Premadasa who was elected in 1988. This marked the beginning of the privatization program and also the period of state action against the JVP insurgency. It was a period of death squads, disappearances, and gross human rights violations. In this climate of repression very few could mount any opposition to the political and, never mind economic, regime of the day. Thus the ruling classes were left to pursue reforms as they wished.

3. The third period occurred after the election of President Chandrika Kumaratunge. In this instance, the reform program secured support due to the popularity and legitimacy of a regime that had defeated the UNP after 17 long years. The UNP rule from 1977 to 1994 was the longest that the Sri Lankan electorate has seen since Independence. It was also a period of great repression and ethnic violence and for that many were glad to see the UNP go. A resilient, new government was elected with the support of the electorate and was able to carry out a series of reforms. However, the UNP did so in a less favorable environment. Economic conditions were less favorable at the beginning of the new government's term. The UNP had to introduce extensive reforms in a society bearing the social contradictions of more than two decades of liberal capitalism. Even under these circumstances and against the odds, the UNP was able to carry out a series of reforms aimed at addressing the economic problems faced by the country.

Even under the favorable political environments enjoyed by these regimes, none of them tried as extensive a reform program as the UNF government set out to accomplish. The UNF also introduced these extensive reforms in a society bearing the social contradictions of more than two decades of liberal capitalism. Even if we confine ourselves to a discussion about average statistics, all the costly number-crunching exercises carried out by economists point to the fact that after more than two decades of liberalized policies, more than a quarter of the population still live under the poverty line (See Table 7). These figures do not include the Northern and Eastern provinces. If these provinces were included, the picture would be much worse. Moreover, recent data on income distribution shows that Sri Lanka remains an extremely unequal society. Preliminary data of the Central Bank Consumer Finance and Socio-Economic Survey for 2003/2004 shows that "the share of the highest income decile in total income, measured by the Gini coefficient, is 0.46. This is one of the highest in Asia. The share of the lowest income decile is 0.13. This is one of the lowest in Asia." If the UNF economic strategy—which, among other things, attempted a significant retrenchment of public employees, extensive privatization, reform of labor laws, and the implementation of institutional changes to land policies—ultimately contributed to a high degree of inequality and economic stagnation, then it is clear that the UNF economic strategy was not a success.
at 38.6 percent, is about twenty three times as high as the share of the lowest decile (1.7 percent) indicating highly unequal income distribution. Similarly the highest two deciles together account for more than half of the total income (53.7 percent), while the lowest five deciles (i.e., the lower half of the total income deciles) account for only about one fifth (19.6 percent) of the total income.”  

This inequality has a regional dimension as well. With close to 50 percent of the GDP concentrated in the Western Province, the other regions are neglected (Table 7). This is reflected in the figures for the share of households in poverty. As shown by Table 7, this figure is 12.2 percent of households for the Western Province but goes up to 40 percent of households in Sabaragamuwa, the worst-off province.  

In the case of Sri Lanka, social inequality has a greater influence on politics than economic inequality. It goes beyond the case of Sri Lanka, social inequality has a greater influence on politics than political power. It goes beyond the case of Sri Lanka, social inequality has a greater influence on politics than economic inequality.

### Table 7. Indicators of regional inequality

<table>
<thead>
<tr>
<th></th>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Western</td>
<td>12.2%</td>
<td>49.4%</td>
</tr>
<tr>
<td>North-Western</td>
<td>30.4%</td>
<td>10.4%</td>
</tr>
<tr>
<td>Central</td>
<td>35.4%</td>
<td>9.9%</td>
</tr>
<tr>
<td>Southern</td>
<td>32.5%</td>
<td>9.3%</td>
</tr>
<tr>
<td>Sabaragamuwa</td>
<td>40.0%</td>
<td>6.7%</td>
</tr>
<tr>
<td>Eastern</td>
<td>n.a.</td>
<td>4.5%</td>
</tr>
<tr>
<td>Eranala</td>
<td>6.7%</td>
<td>4.0%</td>
</tr>
<tr>
<td>Southern</td>
<td>32.7%</td>
<td>9.9%</td>
</tr>
<tr>
<td>Central</td>
<td>32.7%</td>
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</tr>
<tr>
<td>North-Western</td>
<td>30.4%</td>
<td>4.5%</td>
</tr>
<tr>
<td>Western</td>
<td>12.2%</td>
<td>4.5%</td>
</tr>
<tr>
<td>Sri Lanka</td>
<td>26.7%</td>
<td>100.0</td>
</tr>
</tbody>
</table>


37 Central Bank of Sri Lanka, Annual Report 2003. This survey also did not cover Kalmunai, Mannar and Mullaitivu districts, hence the income distribution picture will be worse both socially and regionally.

38 For an analysis of this issue, see David Dunham and Chris Edwards (1997) "Rural poverty and agrarian crisis in Sri Lanka, 1985-95: Making Sense of the Picture,” Research Studies, Poverty and Income Distribution Series No.1 (Institute of Policy Studies). See also, World Bank (1996) Non Plantation Crop Sector Policy Alternatives, for the Bank’s answer to this problem. It amounts to liberalizing land markets so that small paddy farmers will be able to sell their land and turn to something more profitable. This might happen with the expansion of capitalist relations in agriculture, but what is important to focus on is the political process underlying this transition.
enterprises, and the loss of hope about the economic environment had widespread effect. In fact, as argued above, some opinion polls show that in the 2001 elections, the southern electorate voted for the UNP to take care of the economic malaise rather than the civil war. Economic issues remained a high priority for the population throughout the period when negotiations were going on. When a social indicator survey in January 2003 asked a sample to prioritize issues of concern, 48.2 percent chose cost of living, 16.5 percent unemployment and 18.8 percent ethnic conflict (Centre for Policy Alternatives, 2003). Put another way, 64.7 percent placed economic issues at the first priority while 18.8 percent picked the conflict.

Thus the UNF, while beginning a difficult negotiating process with the LTTE, also undertook an economic reform program that led them to confront powerful political forces. This was carried out in a context of persistent poverty, growing inequality, deteriorated conditions for the paddy growing peasantry, and the continuing impact of the economic recession. Despite the enormous economic problems most of the population faced, the UNF leadership either did not understand, or did not want to understand, the negative impacts of the previous 20 years of liberal capitalism. Rather, they believed that what was needed was more of the same, but with a greater degree of intensity. UNF policy documents did not give an inkling of whether the politics of reform itself would generate new conflicts and how it would influence the peace process. Many of the experts give the impression of being written by consultants devoid of any knowledge of Sri Lankan history or any due to its politics.

In contrast to the record of previous UNP regimes, the UNF strategy did not include any significant program that could mobilize political support within the population at large. Examples of such programs are Janasaviya under President Premadasa and Samurdhi under President Kumaratunge. Both are highly publicized poverty alleviation programs that have the socioeconomic objective of poverty alleviation. But they also have political significance. These are programs that the ruling classes use to manage the relationship with the general population while they carry out many other reforms needed for capitalist development. Even the names given to these programs play this political role. Both President Premadasa and Chandrika Kumaratunge subscription to this strategy while carrying out reforms. Therefore while the reform programs alienated large sections of the population, they had also political significance. These are programs that the UNF strategy was to tighten these programs rather than to think of any new innovations. The thrust of the UNF strategy was to remove the tightness of the previous programs, but they also have political significance. These are programs that the UNF leadership believed in the traditional growth and trickle down strategy, the principal thrust was to remove the fetters that prevented markets and the private sector from developing. The idea was to generate economic growth through this link, the poor to the economic growth could not be improved without the critical look at the post-1977 period. Therefore, the UNF leadership either did not understand, or did not want to understand the negative impacts of the previous 20 years of liberal capitalism. Rather, they believed that what was needed was more of the same, but with a greater degree of intensity. UNF policy documents did not give an inkling of whether the politics of reform itself would generate new conflicts and how it would influence the peace process. Many of the experts give the impression of being written by consultants devoid of any knowledge of Sri Lankan history or any due to its politics.
same structural adjustment and stabilization programs promoted by multilateral donors. What it tries to do is legitimize these policies through a poverty alleviation argument. Another aspect of the plan is to carry out a so-called participatory exercise, a new strategy by donors to try and generate support for reforms that they want to promote. The participatory exercises for the PRSP were extremely limited and never reflected any kind of mass participation. For these reasons, the PRSP could not even begin to generate the political support that the UNF needed.40

Within a short period of time, the UNF, while achieving much in the peace process, began to face political difficulties on two fronts. First, the cohabitation exercise failed. Second, the reform process generated a lot of hostility from various social groups because of the direct negative impact some of the policies had on their well-being. However, what was important was not so much the direct impact of these policies. Rather, the problem was the adherence to an ideology that gave the impression that the government cared little about these vital sectors of the population whose support was instrumental to the peace process. The April 2004 elections were a complete reversal of fortunes for the UNP. From their best performance in 2001, they slumped to the worst performance by getting only 35.8 percent of the total national vote, worse even than their 1994 defeat when they secured 41.9 percent. The UNP lost the absolute majority in 14 electoral districts. In all electoral districts there was a reduction in the percentage of total votes as compared to the 2001 election results. The UNF performance by gaining 58.2 percent of the national vote, was an increase of 3.2 percent of the performance in 2001. The results of the elections were a complete reversal of the perception that the UNF/UNP from their two terms in power had gained the confidence of the electorate and strengthened their position in the parliament. The 2004 election results were a clear indication that the UNF/UNP had lost the support of the electorate and that the UNF/UNP had not been able to attract the support of the electorate in the 2004 election. The table below shows the performance of the UNP/UNF in the 2004 election, with respect to the 2001 election.

<table>
<thead>
<tr>
<th>District</th>
<th>2001 Total</th>
<th>2004 Total</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Colombo</td>
<td>37.1</td>
<td>26.0</td>
<td>-11.1</td>
</tr>
<tr>
<td>Gampaha</td>
<td>35.7</td>
<td>36.6</td>
<td>+0.9</td>
</tr>
<tr>
<td>Kalutara</td>
<td>22.3</td>
<td>23.2</td>
<td>-0.9</td>
</tr>
<tr>
<td>Galle</td>
<td>24.7</td>
<td>23.3</td>
<td>-1.4</td>
</tr>
<tr>
<td>Matara</td>
<td>33.0</td>
<td>33.0</td>
<td>0</td>
</tr>
<tr>
<td>Hambantota</td>
<td>39.3</td>
<td>38.3</td>
<td>-1.0</td>
</tr>
<tr>
<td>Matale</td>
<td>36.1</td>
<td>35.8</td>
<td>-0.3</td>
</tr>
<tr>
<td>Kandy</td>
<td>31.0</td>
<td>34.2</td>
<td>+3.2</td>
</tr>
<tr>
<td>Ratnapura</td>
<td>33.7</td>
<td>37.1</td>
<td>+3.4</td>
</tr>
<tr>
<td>Anuradhapura</td>
<td>33.8</td>
<td>37.2</td>
<td>+3.4</td>
</tr>
<tr>
<td>N'Elia</td>
<td>46.9</td>
<td>49.7</td>
<td>+2.8</td>
</tr>
<tr>
<td>Kegalle</td>
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<td>30.7</td>
<td>-3.0</td>
</tr>
<tr>
<td>Kurunegala</td>
<td>29.7</td>
<td>27.8</td>
<td>-1.9</td>
</tr>
<tr>
<td>Puttalam</td>
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<td>31.0</td>
<td>-1.6</td>
</tr>
<tr>
<td>Polonnaruwa</td>
<td>28.3</td>
<td>26.2</td>
<td>-2.1</td>
</tr>
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<td>Anuradhapura</td>
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<td>29.3</td>
<td>-3.0</td>
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<tr>
<td>Moneragala</td>
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<td>-2.2</td>
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<tr>
<td>Badulla</td>
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<td>30.5</td>
<td>-0.6</td>
</tr>
<tr>
<td>Ratnapura</td>
<td>30.6</td>
<td>30.5</td>
<td>-0.1</td>
</tr>
<tr>
<td>Kegalle</td>
<td>25.8</td>
<td>26.4</td>
<td>+0.6</td>
</tr>
<tr>
<td>Jaffna</td>
<td>8.2</td>
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<td>-8.2</td>
</tr>
<tr>
<td>Vanni</td>
<td>13.8</td>
<td>12.3</td>
<td>-1.5</td>
</tr>
<tr>
<td>Batticaloa</td>
<td>9.7</td>
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<td>-8.5</td>
</tr>
<tr>
<td>Amparai</td>
<td>13.6</td>
<td>7.6</td>
<td>-6.0</td>
</tr>
<tr>
<td>Trincomalee</td>
<td>26.1</td>
<td>8.2</td>
<td>-17.9</td>
</tr>
<tr>
<td>Total</td>
<td>43.2</td>
<td>35.8</td>
<td>-7.4</td>
</tr>
</tbody>
</table>

Source: Computed from data from the Election Commissioner's Department, GoSL.

The Economic Agenda and the Peace Process
Can Donor Countries Have a Different Approach?

This section is a reflection on the role of donor countries, taking into account the Sri Lankan experience during the years 2002-2004. This experience tells us where the interests of these countries lie, and what we can expect from them. Our thoughts have to be grounded in this historical experience as it gives us a much more realistic framework within which to explore the future role of donors.

LESSONS OF THE 2002-2004 PERIOD

Sri Lanka has become a fragmented state due to the two-decades-long war. The first two years of the new millennium saw an escalation in the war to the extent that it undermined the growth of capitalism. The economic crisis of 2001 forced the ruling classes to begin negotiations with the LTTE, which was then controlling part of the country. The crisis was so bad that the UNF leadership achieved a ceasefire agreement soon after it came to power.

The LTTE objective was to extend its control over the North-East and the sea, gain access to government-controlled areas (especially in the Jaffna peninsula), gain recognition internationally, and control the resources that could flow into the North-East for rehabilitation purposes. The LTTE's objectives were to extend its control over the country, and begin negotiations.

The most remarkable aspect of the UNF strategy was the extensive international support that it managed to generate. Norway remained as the chief facilitator and mediator; while the United States, Japan and the EU became co-chairs of the negotiation process. As our data show, the government received generous financial support from donors, especially Japan, the ADB, and the World Bank.

Donor countries agreed with the fundamental objectives of the UNF strategy. They were supportive of the negotiations between the GoSL and the LTTE as they saw the essence of peace in that the two sides were trying to reach an agreement that would be mutually agreeable. The LTTE's terms were so bad that the economic crisis of 2001 forced the ruling classes to underwrite the growth of capitalism.

The economic policies of the UNF were oriented toward the creation of a free market economy, with the aim of attracting foreign investment and promoting economic growth. The LTTE's控制 over the North-East and the sea posed a challenge to these objectives, as it threatened to disrupt the flow of resources into the region. The LTTE's policies were therefore aimed at controlling the economy, and preventing the establishment of a free market.

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In supporting peace efforts, donors focused their support on two sets of actors, the private sector and civil society. This dovetailed with the overall agenda of security and promotion of the market economy. Within the liberal agenda of politics and economics, these two groups are natural allies of donor countries, the former because of its role in supporting the economic agenda, the latter for helping to promote the liberal agenda. However, the 2002-2004 experience shows the inability of these actors to influence political outcomes.

Despite donor approval and consensus about the approach undertaken by the UN, there were debates and discussions about various aspects of the strategy. However, these debates did not result in any changes in the formal policy of most of the countries. Nor did they result in significant policy shifts in donor approaches to either the LTTE or GoSL. Moreover, donors proved largely incapable of controlling the peace process once it started to unravel, especially in getting the LTTE to rejoin the negotiation process after they withdrew. The most likely answer is the latter. As an example of a different response to the Sri Lankan conflict, take the example of India when the Indo-Lanka agreement was signed. When the negotiations were getting nowhere, India intervened directly to put pressure on all parties. This is not to argue that this approach was correct. But it shows that India intervened because it was in its strategic interest to do more than they were already doing.

The likely scenario in the near future is that none of the parameters of Sri Lanka's conflict will change. The characteristics of such a scenario include:

- Sri Lanka will remain a fragmented state for many more years to come. Both parts of the country and both political leaderships will operate in a globalized world and try to use international factors for their benefit.
- The primary interest of multilateral donors like the IMF, the World Bank, and the ADB will be the promotion of a liberal economy. The relationship of Sri Lanka with these agencies will depend largely on the success of the economic reform program.
- The United States will have an interest in Sri Lanka because of its concern for stability in the region. But the United States is likely to approach this issue in close cooperation with India. It is also likely to work closely with India, especially as both countries are vying for a permanent position on the U.N. Security Council.
- Japan is likely to remain Sri Lanka's largest donor. Its new interest in conflict resolution is unlikely to take it beyond what it is doing now. The approach will be based mostly on diplomacy and persuasion.
- Norway will continue to occupy the unique position of facilitator and mediator but is unlikely to contribute any serious policy shift.
- Many other donor countries providing relatively small amounts of aid are unlikely to be able to contribute to any serious policy shift.
Given this reality of interests and positions by donor countries, it can be helpful to share the concepts and ideas that have motivated some of the social activists who have been supportive of the peace process but critical of the approach taken by the UNF and supported by donors.41 This is done with the hope that it will influence the thinking of donors who are receptive to these ideas.

The basic principles underlying the position taken by these activists are:

1. A durable peace involves more than a deal between the LTTE and the ruling classes. It involves not only an elite pact that could lead to reforms of the Sri Lankan state, but a reconstitution of the relationship between rulers and the ruled. In this reconstitution, principles of pluralism, democracy, human rights, and social justice are important.

2. The primary actors in this process of transformation toward durable peace are internal political forces. Externally induced solutions will not have political legitimacy and will not help ensure a sustainable peace.

3. At present, internal political forces are unable to reconstitute the Sri Lankan state in this manner. The internal balance of political forces is such that Sri Lanka is likely to remain a fragmented state for some time to come. The primary task is to help create and promote a political space that will promote various activities and organizations that will strengthen the values of pluralism, democracy, human rights, and social justice. The signing of the CFA in 2001 should be viewed as a point of transition that creates such a space to promote these goals.

4. Keeping these historical processes in mind, the task is to find creative and new political space that will promote these values. Although the LTTE and the Sinhala Armed Forces should not be viewed as unduly influenced by the LTTE, they do not have the capacity and legitimacy to promote the values of pluralism, democracy, human rights, and social justice. The task is to help create a political space that will promote these values.

5. Within this political space, some of the specific tasks are:

   1. Maintaining the ceasefire. Although the ceasefire agreement has created a qualitatively new situation there is no guarantee that it will hold. Renegotiating the agreement is difficult at the moment but the process of maintaining the ceasefire is important. Keeping these historical processes in mind, the task is to find creative and new political space that will promote these values.

   2. Resuming negotiations. Every effort should be made to resume negotiations. Although there are contacts between the LTTE and the government, they lack legitimacy among the majority community. In fact, some of these efforts are viewed as underhanded efforts to support the LTTE.

These activists are not alone in their support for a political space that will promote values of pluralism, democracy, human rights, and social justice. The signing of the CFA in 2001 should be viewed as a point of transition that creates such a space to promote these goals.
3. One of the drawbacks of the last round of negotiations was the total neglect of southern politics, especially the relationship between the two major parties. This is in contrast to some of the earlier efforts where this was given its due importance. Some sort of an understanding between the two major parties is necessary not only for the success of negotiations, but also for the isolation of Sinhala extremist groups. This is the only way their influence within the Sinhala polity can be isolated.

4. There should be greater effort to broaden the social base for peace in the South beyond the private sector and organizations identified as civil society. Many organizations that have a mass base such as trade unions, student groups, and rural organizations are still outside the support base for the peace process. However, their support cannot be mobilized if the objective of the economic agenda is merely to carry out fiscal policies and structural reform so that those who have capital can continue the accumulation process.

5. The economic reform program has to be driven by a broader vision of transforming Sri Lankan society and sustaining durable peace rather than a search for growth figures. This calls for (a) a much better understanding of the politics of economic reforms; (b) strategies for building political support for reform while not undermining support for the peace process; and (c) greater focus on timing and sequence of support for the peace process and of economic reforms. The political agenda behind the reform program will also be different. The political agenda behind the reform program will be less driven by the interests of the economic reform process and more driven by the interests of the peace process.

6. During the last round of negotiations, the pressure on the LTTE and GoSL on issues of democracy, human rights, and pluralism must be maintained. Those who have interpreted peace within a security and development framework have been happy to appease the LTTE despite its authoritarianism and Tamil chauvinism. This tendency has also dominated the last round principally because peace has been viewed as a deal between the LTTE and GoSL. If, on the other hand, durable peace is viewed as a process where the political actors themselves have to be transformed (instead of aiming only at a deal among political actors to provide security and stability), the issues of democracy, human rights, and pluralism are given more importance. This is necessary to tackle the other equation in Sri Lanka's peace process, the rights of the Muslims.

7. Pressure on the LTTE and GoSL on issues of democracy, human rights, and pluralism must be maintained. Those who have interpreted peace within a security and development framework have been happy to appease the LTTE despite its authoritarianism and Tamil chauvinism. This tendency has also dominated the last round principally because peace has been viewed as a deal between the LTTE and GoSL. If, on the other hand, durable peace is viewed as a process where the political actors themselves have to be transformed (instead of aiming only at a deal among political actors to provide security and stability), the issues of democracy, human rights, and pluralism are given more importance. This is necessary to tackle the other equation in Sri Lanka's peace process, the rights of the Muslims.

8. The economic agenda and the peace process are interlinked. The economic agenda has to be driven by a broader vision of transforming Sri Lankan society and sustaining durable peace rather than a search for growth figures. This calls for (a) a much better understanding of the politics of economic reforms; (b) strategies for building political support for reform while not undermining support for the peace process; and (c) greater focus on timing and sequence of support for the peace process and of economic reforms. The political agenda behind the reform program will also be different. The political agenda behind the reform program will be less driven by the interests of the economic reform process and more driven by the interests of the peace process.
to promote the policy of bilingualism, which is an important ingredient of pluralism. In fact, there is no guarantee that the success of negotiations will promote such policies. As argued by Darini Senanayake-Rajasingham, devolution might result in ethnic enclaves rather than pluralism (1999). But nonetheless many such interventions can be undertaken while negotiations are continuing.

While recommending these possibilities in promoting a durable peace, it is necessary to end this section with a caution about negative outcomes in the near future. The UNP strategy came to an end with their defeat in the 2004 elections. The behavior of the UPFA government shows that it has understood how the UNP’s economic policies alienated various social classes. As a result, it was quick to implement several policy measures to satisfy their interests, such as reintroducing the fertilizer subsidy, recruiting graduates for state employment, and retreating from further privatization. But most of these policies were done in an ad hoc and contradictory manner. Moreover, the need to manage an unwieldy coalition and the need to respond to new political forces will support the government’s efforts to extend the economic agenda in the South despite the economic problems in the North-East and the economic agenda of the LTTE as well. The war has been ongoing for over 20 years, and the LTTE’s political and economic policies are complex. In such a context, the government will have to address the contradictions of the peace process and economic reforms in such a way as to address the economic agenda of the South while satisfying the economic needs of the North-East.

Given the present balance of political forces in the South, the result of such an effort could be large-scale instability. The more extremist sections in the South will capitalize on the contradictions of the peace process and economic reforms. In such a context, donors will support the government’s efforts to extend the economic agenda in the South despite the economic problems in the North-East and the economic agenda of the LTTE as well. The war has been ongoing for over 20 years, and the LTTE’s political and economic policies are complex. In such a context, the government will have to address the contradictions of the peace process and economic reforms in such a way as to address the economic agenda of the South while satisfying the economic needs of the North-East.

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