

63177

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

2000 – 2005



Sunil Bastian

SIX - PART  
SERIES

VOLUME  
N<sup>o</sup> 5



Koninkrijk  
der Nederlanden



The Asia Foundation



Sida



# THE ECONOMIC AGENDA AND THE PEACE PROCESS

PART OF THE

SRI LANKA STRATEGIC CONFLICT ASSESSMENT 2005

By Sunil Bastian



Koninkrijk  
der Nederlanden



The Asia Foundation



Sida



The governments of the Netherlands, Sweden, and the United Kingdom, in collaboration with The Asia Foundation and the World Bank funded this project. The contents of the studies should not be construed as reflecting the views of the five funding agencies.

© Copyright 2005

Netherlands Ministry of Foreign Affairs  
Swedish International Development Cooperation Agency  
The Asia Foundation  
Government of the United Kingdom of Great Britain and Northern Ireland  
World Bank

For reproductions of this publication please contact:



**The Asia Foundation**

3 1/A Rajakeeya Mawatha  
Colombo 7, Sri Lanka  
Phone: +94 11 2698356  
Fax: +94 11 2698358  
[www.asiafoundation.org](http://www.asiafoundation.org)

All rights reserved

Printed in Sri Lanka

# Contents

Acknowledgements.....	2
About the Authors.....	3
Acronyms.....	4
Executive Summary.....	5
<b>1. Introduction.....</b>	<b>11</b>
Liberal Capitalism and Ethnic Conflict.....	11
The Context of the UNF Electoral Victory.....	13
<b>2. The UNF Strategy.....</b>	<b>19</b>
The Ceasefire Agreement and Beginning of Negotiation Process with the LTTE.....	20
Economic Reform Program to Further the Growth of a Market Economy.....	21
Internationalization.....	22
Role of Big Business.....	25
<b>3. Politics of Donor Countries.....</b>	<b>29</b>
<b>4. Defeat of the UNF.....</b>	<b>35</b>
<b>5. Implications for International Donors.....</b>	<b>41</b>
Can Donor Countries Have a Different Approach?.....	41
Lessons of the 2002-2004 Period.....	41
Building a Social Movement Toward Peace.....	43
<b>Bibliography.....</b>	<b>47</b>

## Acknowledgements

All views expressed in this study are the author's and do not represent those of the commissioning agencies, the facilitators of this study, or those who were interviewed. I would nevertheless like to thank the following for their contributions to this study: first, Jonathan Goodhand, Bart Klem, and Anthea Mulakala who provided feedback on earlier drafts of this report; and second, Alan Martin and Gina Genovese, who provided valuable editorial assistance.

## About the Authors

Sunil Bastian is a research fellow at the International Centre for Ethnic Studies in Colombo. His current research focuses on the relationship between the politics of capitalism and identity conflicts. At present he is working on a project that is analyzing the politics of donor countries in the context of Sri Lanka's liberal capitalism and ethnic conflict. He also has extensive consultancy experience having worked for a number of aid agencies and non-governmental organizations during the past two decades.

## Acronyms

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

## 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 about the internal contradictions such a strategy would present or what impact it would have on the peace process.

### LIBERAL CAPITALISM AND ETHNIC CONFLICT

The study begins with a brief survey of literature analyzing the relationship between the liberalized phase

of capitalism in Sri Lanka and the ethnic conflict.

Broadly, 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 it has to be settled so that the process of capitalist development can continue. This approach does not see any link between liberal capitalism and conflict. This tradition came into prominence with the escalation of the war, especially after 1995. The objective has been to point out the high economic and social cost of war and provide an argument for peace. In addition to research institutions, civil society groups campaigning for peace have sponsored such studies. The political agenda of these studies has been to bring about peace so that the expansion of liberal capitalism can continue.

In the second group are studies that have been critical of liberal capitalism. Some of the earliest contributions within this tradition looked at the differential impact of public policies on ethnic groups. The focus of attention has been language, employment, education, and land settlement policies. Even before Sri Lankan Tamils articulated the demand for a separate state, discrimination in these areas of public policies has been their major grievance.

A few critical studies in this tradition have looked at the role of donors within these policies. Most attention has been paid to land settlement policies-especially the Accelerated Mahaweli Programme that was funded by most of the bilateral donors. Since these policies have been discriminatory against Sri Lankan Tamils, donors have been criticized for supporting such policies.

This study is based on a framework of analysis proposed by the late Newton Gunasinghe, one of the pioneers of Marxist sociological studies of Sri Lanka. In one of his



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 battlefield. 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 Karunayake 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 one of the two major parties were no longer, and coalition governments became the norm. The PA government elected in October 2000 did not even last a year after the defection to the opposition 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.

It was during this multiple crisis faced by the Sri Lankan state that the PA government invited the Norwegians to facilitate negotiations between the LTTE and the government in February 2000. Subsequent events showed that it was a decision taken reluctantly by the PA. Nevertheless it was a significant departure from the hitherto Indo-centric involvement of external actors in Sri Lanka's conflict.

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, as polls showed that the public had more confidence in the UNF's ability to manage the economy,

## THE UNF STRATEGY

The strategy of the UNF government to deal with the crisis consisted of three elements: a ceasefire agreement and beginning negotiations with the LTTE; an extensive program of economic liberalization; and the mobilization of international support for the peace process as well as for the economic agenda.

The UNF signed the CFA with the LTTE in February 2002. This agreement accepted the presence of two armies in Sri Lanka and control of territory by LTTE; provided rules for freezing control of territory by the two armies at the point of signing the CFAs; allowed unarmed LTTE

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 CEA 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 reducing the size of public administration; privatizing and restructuring a number of state owned enterprises; reforming labor laws and introducing 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. With the CEA in place, the role of Norway--a long-time facilitator in negotiations between

the two sides--was to become much more significant. The UNF also successfully lobbied to add three new actors, the United States, Japan, and the European Union (EU), as co-chairs of the peace process.

## **ROLE OF BIG BUSINESS**

A significant development during the period covered by this study is the emergence of several organizations representing big business that championed peace. Despite the length of the war and its potentially negative economic impact, it was principally the economic crisis of 2000-2001 that motivated corporations to join the peace campaign.

## **POLITICS OF DONOR COUNTRIES**

The UNF strategy received wholehearted support from most major donor countries as it coincided with their own political agenda and interests. They believed that the promotion of a liberal market economy and strengthening of liberal institutions and values was the way forward for peace and prosperity in Sri Lanka. Promoting a deal between the LTTE and the Government of Sri Lanka (GoSL) was thus necessary to implement this agenda.

Not every country endorsed the UNF strategy, however. Although India welcomed the attempt to find a negotiated settlement to the conflict it was much more suspicious of the LTTE's intentions than Western donors. The United States was also skeptical about the LTTE's seriousness in pursuing a negotiated settlement--an attitude influenced by the aftermath of 9/11. On several occasions the U.S. emphasized that the LTTE had to concretely demonstrate that they had given up terrorism in order to gain official recognition.

The increased amount of aid given to Sri Lanka is perhaps the best indicator of support given to the UNF strategy by donors. According to Central Bank data the total amount of aid between 2002 and 2003 increased

by nearly 350 percent, from Rs. 17.2 million to Rs. 61.2 million. The bulk of the aid went into management of the economy and revival of the normal development process. For example, a preliminary analysis of the projects for which aid was committed in 2003 shows that only 15 of the 62 projects were directly related to peace or had provisions for work in the North-East.<sup>1</sup> The rest of the projects related to the normal development process.

This is not to say that there are no new projects aimed at rehabilitation of the North-East. The 15 projects mentioned above show that donors were keen to expand in the areas affected by war. But large-scale support (including from the highly publicized Tokyo donor conference) to the North-East did not materialize because of the failure of the peace process.

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 to send back failed asylum seekers.

## **DEFEAT OF THE UNF**

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.

Given the long rivalry and antagonism between the PA and UNP, cohabitation between the two parties was troubled from the beginning and the coalition lasted barely two years. 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 maintain the support of the southern electorate. If the UNF had won the 2004 election, the peace process and the economic strategy would have been strengthened. But this was not to be. The UNF was convincingly defeated in the 2004 elections.

The UNF 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 side campaigned on a platform of negotiations-a

---

<sup>1</sup> The use of North-East throughout this report recognises the contested nature of the term. "Northeast" or "North and East" would denote different political approaches to the aspirations of Tamil nationalism.

feat repeated in 2001. 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 other than 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. This was what contributed to the UNF's defeat in the 2004 elections.

## **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.

As we have argued, most of the donor activities around peace are based on the notion of a "liberal peace." The idea is that the establishment of liberal institutions both in the economy and polity will ensure peace. However, such a premise has to be questioned, as there is enough evidence both in Sri Lanka and other countries to show that the thesis of "liberal peace" does not work.

In questioning the conceptual basis of liberal peace we need to focus on issues of social justice and group rights, especially in relation to the question of identity. Too often liberals believe that group rights can be ensured through the protection of individual rights. This is not always the case. Liberal principles that virtually ignore the identity of individuals have very few answers for identity-based conflicts. Rather, we need to bring social justice and group rights as central themes into the current debate on security and development.

In the case of Sri Lanka, rethinking these basic principles will mean 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 important.
- The primary actors in this process of transformation toward durable peace 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 Lankan society and sustaining durable peace, rather than a search for growth figures. This calls for: more attention being paid to social justice and group rights within the reform program; better understanding of the politics of economic reforms; strategies for building political

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 UNF'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 closely associated with the president are keen to begin the negotiation process, several obstacles remain. They include: a lack of trust between the UPFA leadership and the LTTE; 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).

These factors have made managing the economy more difficult. The UNF is clearly hoping to wrestle control of the presidency and parliament so it can continue to re-implement the policies that it began. This could even include giving the LTTE interim control of the North-East. Donors, if they work within the same framework as before, could be supporting these steps.

Given the present balance of political forces in the South, the result of such an effort could be large-scale instability in the South. The more extremist sections in the South will capitalize on the contradictions of the peace process and economic reforms. In such a context, the UNF could return to its authoritarian politics of the 1977 to 1989 period. The worst scenario is that donors will support the twin strategy of extending the authoritarian rule of the LTTE in the North-East and the economic agenda in the South despite the repression and instability of the government.



# 1. 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 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 and a majority in the Eastern Province.

However, despite the participation of Tamils in the electoral process, there were already sporadic incidences of violence, especially in the North. In addition, a Tamil militancy that did not completely believe in the parliamentary process was growing in Tamil dominated areas. This deterioration of relations between Sri Lankan Tamils and the Sri Lankan state took a qualitatively new turn when the latter decided to adopt a harsh military stance toward Tamil militants. In 1979, the army was sent to the North to quell the Tamil militancy. At the same time the Prevention of Terrorism Act was enacted, providing the state with extensive repressive powers. What followed is a civil war that has resulted in Sri Lanka becoming a fragmented state.

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, making use of varied conceptual and theoretical frameworks. As a result, the political agendas behind them have been different.

Broadly this literature can be divided into two groups. In the first group are those who favor the liberalized economic policies and ignore the social contradictions generated by liberal capitalism. They do not see any link between these policies and conflicts in society either in the North-East or the South. Most of this type of writing comes from mainstream economists. Their political agenda is to promote capitalist accumulation and deepen capitalist relations in society.

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.<sup>2</sup> 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 earliest 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.<sup>3</sup>

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.

Other studies have attempted to establish the claim by the Tamil community that these policies have led to shifts in ethnic composition in favor of the Sinhalese, especially in the Eastern province, and were therefore discriminatory against Tamils.<sup>4</sup> Others still, have explored Sinhala nationalist symbolism within the Mahaweli program (Tennekoon, 1988). Few have focused critically on donors.<sup>5</sup> The land issue is a policy area that is politically sensitive as it plays a critical role in Tamils' calls for a separate state. As a result, studies have questioned the validity of Tamil land grievances and indeed the basis of their demands for a separate state.<sup>6</sup>

Apart from looking at specific policies, this tradition of critical scholarship of liberal economic policies has

- 2 As examples of this tradition see: Arunatike Nisha, Sisira Jayasuriya, Saman Kelegama (2000) *The economic costs of war* (Institute of Policy Studies, Colombo); L.M.Grober, S.Gunasekham (2001) "The economic effects of Sri Lanka's civil war", *Economic Development and Cultural Change*, Vol. 41, No. 2.
- 3 See for example, Sunil Bastian (1984) *Ethnic conflict and university admission*, in *Ethnicity and Social Change in Sri Lanka*, (Social Scientists Association, Colombo); E.Nissan (1996) *Sri Lanka: Minority Rights Group International Report* (Minority Rights Group, London);Amita Shastri (1990) "The material basis for separatism: The Eelam movement in Sri Lanka," *Journal of Asian Studies*, Vol. 49.
- 4 See P.Peebles (1990) "Colonization and ethnic conflict in the dry zone of Sri Lanka" *The Journal of Asian Studies*, Vol. 49, No.1.
- 5 See David Gillies (1992) "Canadian Aid, Human Rights and Conflict in Sri Lanka", in Robert Miller (ed), *Aid as Peacemaker* (Carleton University Press, Ottawa).
- 6 See G.H.Perris (1991), "An appraisal of the concept of a traditional Tamil homeland in Sri Lanka", *Ethnic Studies Report*, Vol.9, No.1.

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.<sup>7</sup> 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 of 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. This analysis is influenced by an essay written by the late Newron Gunasinghe after the

July 1983 riots.<sup>8</sup> In this essay, Gunasinghe focused on the changing relationship between the state and different social classes among the Sinhalese because of liberal capitalist policies and the impact of these policies on the ethnic conflict. His foci were small businesses and the urban poor in Colombo, where much of the violence was centered. He argued that the inauguration of liberal economic policies played a role in the riots as they led to loss of state patronage by small businesses and undermined welfare benefits received by the urban poor.

This paper also focuses on the changing relationship between the state and social classes as a result of the economic reform program that the UNF undertook after signing the CFA with the LTFE in February 2002 and its impact on the peace process. It argues that the economic crisis of 2001 prompted the UNF to go into the CFA and begin negotiations. However, along with negotiations, the UNF undertook a series of economic reforms that reconstituted the relationship between the state and several social groups, including the middle and working classes, and the peasantry. This rearrangement of the relationship between the state and these classes had a negative social impact. It was also undertaken in an environment that was already exhibiting social contradictions borne from more than 20 years of liberal capitalism. These factors were also responsible for the defeat of the UNF in April 2004 elections that terminated the UNF's search for peace.

## THE CONTEXT OF THE UNF ELECTORAL VICTORY

The first two years of the new millennium witnessed the coming together of a number of factors that deepened the crisis faced by the fragmented post-colonial Sri

7 See Chapter 2 in Robert J. Muscat (2002) *Investing in peace. How development assistance can prevent or promote conflict* (M.E. Sharpe, New York); chapter on Sri Lanka in Ross Malik (1998) *Development, ethnicity and human rights in Asia*, (Sage, New Delhi).

8 See Newton Gunasinghe (1996) "The open economy and its impact on ethnic relations in Sri Lanka," (ed) Sasanka Perera, *Newton Gunasinghe, Selected essays* (Social Scientists Association, Colombo).



Lankan State.<sup>9</sup> 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 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 battlefield. 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 Jaffna peninsula 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 PA government embarked on a constitution, making a process to tackle what the PA leadership called the "core issues." The principal aim of this exercise was to draft a constitution that gave the North-East areas 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 draft proposals of reforms to the parliament in August

2000. But in the absence of support from the main opposition party, the UNP, the government withdrew its proposals from parliamentary debate.

In October 2000, the PA government faced fresh general elections. In an election marred by violence the PA was returned to power.<sup>10</sup> One of the most violent events of the election that received a lot of publicity was the killing of a number of supporters of the SLMC, a coalition partner in the PA government in the Kandy district. The accused perpetrators included the former Deputy Minister of Defense of the PA government, his sons, and several of his supporters. The judicial process around this case is still continuing, but politically it has demonstrated the internal rivalries within the government and the shaky relationship between the PA and SLMC.

The PA was returned to power, securing 42.7 percent of the popular vote and electing 107 members of parliament. Although this was only two more MP seats than they won in 1994, what is interesting to note is that their percentage of total votes dropped by 3.9 percent. The explanation for this lies in the number of bonus seats that the PA won due to its absolute majorities in 15 of the 19 electoral districts—where parties predominantly supported by the majority community usually obtain the largest number of votes. However, despite retaining the bulk of its support, the PA did not have an absolute majority, forcing it to form a coalition government with the SLMC.

What was more politically significant in this election was the entry to parliament of the Janatha Vimukthi Peramuna (JVP) for the first time. Securing 5.7 percent of the total votes, the JVP managed to elect 10 MPs, eight on the basis of electoral district results and two from the national list. The JVP members came from

---

9 The term "fragmented state" more accurately describes Sri Lanka than the notion of failed states popular in donor literature. The usage of these terms is not just an academic exercise. They legitimise various forms of external political interventions. <sup>1</sup> For an elaboration of the concept of a fragmented state in relation to Sri Lanka, see Erin K. Jenne (2003) "Sri Lanka: A Fragmented State," in Robert I. Rieber (ed.) *State Failure and State Weakness in a Time of Terror* (Washington, D.C.: Brookings Institution Press).

10 For a discussion on electoral violence during this period, see K.M.de Silva (2002) "Sri Lanka's Electoral System and Electoral Machinery 1931-2002: A Historical and Political Analysis." A paper presented to an international conference on Electoral Processes and Governance in South Asia, organized by International Centre for Ethnic Studies, Kandy, 21-23 June 2002.

Colombo, Gampaha, Kalutara, Galle, Matara, Hambantota, and Kurunnegala. All except Kurunnegala 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.<sup>11</sup>

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).

This was a repetition of a pattern where the Sri Lankan state was able to secure donor support to weather economic difficulties and continue with development plans while also waging a civil war. This has been the case since 1977 when the economy began to be liberalized with donor support. So long as Sri Lanka continued in this broad direction of economic development and implemented reforms, donor support was forthcoming despite the war.

However, IMF support could not rescue the economy in 2001, when a severe drought that particularly affected the supply of energy and agriculture (including export-oriented plantation agriculture) took a toll on the economy. The economic impact of the war also took a turn for the worse with the LTTE attack on the only international airport at Katunayake on July 24, 2001. It was one operation where the LTTE's primary objective was to inflict damage on the economy. The result was that 2001 went down in modern Sri Lankan economic history as the only year since Independence when the economy contracted--to the tune of 1.5 percent of the GDP.

**Table 1. Selected Economic Indicators**

	1999	2000	2001	2002	2003
GDP (% change)	4.3	6.0	-1.5	4.0	5.9
Budget Deficit (% GDP)	-7.5	-9.9	-10.8	-8.9	-8.0
Govt. Debt (% GDP)	95.1	96.9	103.2	105.4	105.9
External assets (months of same year of imports)	5.2	3.5	4.5	4.9	5.8
Debt service ratio (% export of goods and services)	15.2	14.7	13.2	13.2	11.6

Source: Annual Reports of the Central Bank of Sri Lanka, 1999-2003

<sup>11</sup> 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.

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 answer to the question, without much success.

Following the violence of "Black July" in 1983, India assumed a much more direct interventionist role. This event not only resulted in a large number of Tamil refugees moving to India, but also in the migration of

the bulk of the political leadership of Sri Lankan Tamils, both parliamentary and militant, to India.

From this point on, India was a direct actor in Sri Lanka's conflict without any qualms about whether she is a facilitator, mediator, or any other terms fancied by conflict resolution literature. India played a military role by training Tamil militants, and monitoring and blocking any other country from giving military assistance to Sri Lanka. It applied political pressures on the GoSL to reform the Sri Lankan state in order 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 Gandhi. 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 close to 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.

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 CEA, 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 the 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

**Table 2. Performance of UNP in Proportional Representation Elections**

	% of valid votes	Members elected from electoral districts	National list	Total
1989	47.6	110	15	125
1994	41.9	81	13	94
2000	38.1	77	12	89
2001	43.2	96	13	109
2004	35.8	71	11	82

Source: Computed from data from the Department of Elections, GoSL.

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.<sup>12</sup>

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 it would produce 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 of valid votes to be eligible for seats in parliament. Provisions were also in place such that MPs would lose their seats if they crossed over. The result would have been a legislature where the two larger parties dominated and MPs would be under the control of parties. However, the system that was ultimately established diluted both of these provisions. 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.<sup>13</sup>

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 achievement under PR, if we leave out the 1989 elections which were held under conditions of extensive violence.<sup>14</sup> What is more, the UNP outperformed the PA

<sup>12</sup> If we assume that the ultimate political objective of the Norwegian led peace process was reconstituting Sri Lanka as a federal state, with LTFE in control of North-East, the critical question is: what will be India's attitude toward such an outcome. At the time of the peace process there were many Indian writings and analysis hostile to such an idea. Colombo was also full of speculations about what India really thought about the involvement of external actors, especially Norway-despite diplomatic niceties to the contrary.

<sup>13</sup> See A.J. Wilson (1980), *The Gaullist System in Asia*, The Constitution of Sri Lanka (1978) (Macmillan Press, London) and Sunil Bastian (2003) "The Political Economy of Electoral Reform, Proportional Representation of Sri Lanka," in Sunil Bastian, Robin Luckham (ed) *Can Democracy be Designed?* (Zed Books, London), for an analysis of the establishment of the PR system and its link with the politics of establishing a liberalised economy.

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 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 PA. Given what had happened to the economy under the PA, this was not surprising.<sup>15</sup> Hence economic factors played a significant role in the UNF's victory in December 2001.

---

14 This was the period of Indian Peace Keeping Force presence in the North-East and the JVP led opposition to the Indo-Lanka Accord in the rest of the country. The JVP launched a violent campaign calling for the boycott of elections, but voter turnout was low and the opposition Sri Lanka Freedom Party could hardly mount a campaign.

15 The most important poll carried was out by Dig-Marg Smart. Results of these polls were regularly published in the Sunday Times. See, for example, Sunday Times, 11 November 2001.



## 2. The UNF Strategy

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

	1990	1995	2000
GDP (%change)	6.4	5.5	6.0
Per capita income (PPP 1975 Int\$)	942	1141	1322
Average annual per capita income growth, preceding five-year period	3.36	3.90	2.99

Source: World Development Indicators 2002

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 a 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 helped improve 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)

These economic achievements in the middle of a conflict can be attributed to a number of factors. First,

as the civil war became confined to the North-East over the years it moved the impact of the conflict away from the locus of economic growth. As shown by Table 4, close to 50 percent of Sri Lanka's GDP is now produced in the Western Province.

Province	% Share of the GDP (2000)
Western	49.4
North-Western	10.4
Central	9.9
Southern	9.3
Sabaragamuwa	6.7
Eastern	4.5
Uva	4.0
North-Central	3.8
Northern	2.1

Source: White paper presented by GoSL to the Oslo meeting, 25 November 2002

Second, even when the war affected government finances, there was always generous donor support to overcome the difficulties. As we have mentioned in the previous section, this happened in 2000 and 2001, when a spending spree to buy arms affected the macroeconomic fundamentals. Third, for those years when the global economy performed better, the Sri Lankan economy also benefited despite the war. Another

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 Karunayake 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.<sup>16</sup>

### **THE CEASEFIRE AGREEMENT AND BEGINNING OF THE NEGOTIATION PROCESS WITH THE LTTE**

Soon after winning the election and with the help of Norwegian mediation, the UNF government entered into a ceasefire agreement with the LTTE. The CFA was signed in February 2002. The speed with which this was done made it abundantly clear that the UNF was in touch with the LTTE before its election victory. In fact, this was a major issue the PA tried to capitalize on during the election campaign but failed.

The ceasefire was based on an agreement signed on February 22, 2002. It accepted LTTE control of certain

areas of the country and the presence of two armies controlling different parts of the territory. Several clauses defined what each army could and could not do to maintain the status quo while the talks continued. Other clauses stipulated that each side must give 14 days notice if they wanted to withdraw from the agreement. Finally, a ceasefire monitoring mission composed largely of representatives from Scandinavian countries was established.

The agreement had elements that were a radical departure from political opinions hitherto held by Sri Lanka's political leadership. It also went counter to the position of India, the most important strategic neighbor for Sri Lanka. The agreement was a first in many other regards. Never before had the GoSL accepted that a rebel group controlled parts of the country or conferred legitimacy on it by entering into such an agreement. Not only that, but the rebel group had the freedom to hold territory, keep their arms, and engage in political activities in the areas under army control. These developments showed the extent of the crisis facing the country. A never-ending war and a devastated economy were responsible for driving the Sri Lankan political class to think the unthinkable.

The UNF's negotiation strategy was quite different from ever before. It was what conflict resolution experts described as a "step-by-step" approach. The defining characteristic was the decision not to tackle difficult political issues that could undermine the negotiation process right at the beginning as there was a fear this could lead to a breakdown in talks. Rather, the focus at the initial stages was meeting the immediate needs of the population in the North-East, a view shared by the LTTE. During previous negotiations between the PA government and the LTTE, the LTTE had unsuccessfully demanded that rehabilitation needs be addressed first, before negotiating on political issues.

The direct negotiations between the LTTE and the GoSL lasted from September 2002 to March 2003. A

---

16 "Honesty is the only guarantee towards peace," Policy statement from Prime Minister, Daily News 23 January 2002.

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.<sup>17</sup>

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."<sup>18</sup> The government announced its intention to move the liberalization process forward, with the ultimate objective of achieving a 10-percent growth rate, as some East Asian neighbors had succeeded in doing.

With the objective of achieving 10-percent growth, the UNF embarked on a series of policy measures to stabilize the economy and bring about major structural reforms. On the stabilization side, measures were

undertaken to improve the revenue position as well as curtail expenditure. Revenue-related measures included expanding the number of goods brought under VAT, the introduction of a single VAT, and a tax amnesty to expand the revenue base.

As 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 increase, reducing and streamlining defense expenditure, better targeting the welfare expenditure, limiting resource allocation for unclassified and unforeseen expenses and controlling 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.<sup>19</sup> Apart from this, the government took steps to restructure major state-owned institutions like the Ceylon Electricity Board, railways, and establish a revenue authority.

Steps were undertaken to move forward with the much-delayed retrenchment of state employees. A civil service reforms program was announced in the 2004 Budget,

<sup>17</sup> See, Jayadeva Uyangoda, Peace Watch, Polity, Vol.1, No.3 and Sunanasingi Liyanage, The LTTE's pull-out from the peace talks - a comment, Polity, Vol.1, No.3, for an analysis of the LTTE withdrawal from negotiations.

<sup>18</sup> Government of Sri Lanka (2003) Regaining Sri Lanka: Vision, strategy for accelerated development (Colombo).

<sup>19</sup> Central Bank of Sri Lanka, Annual Report 2003



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 Termination of Employment and Workmen Act, Industrial Disputes Act, Industrial Disputes-Hearing and Determination Proceedings Act, and 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.

## INTERNATIONALIZATION

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 revival. The fact that the prime minister considered international opinion a key factor in guaranteeing peace in Sri Lanka was clear from the very first policy statement he made to parliament before the CFA was signed. Speaking on the conflict he said: "The concern of India as well as donor countries has been drawn towards this problem more than ever before. They steadfastly advocate a political solution to the war. In the context the center of attention is international opinion. A solution to the North-East problem will be through international opinion. We must focus our attention accordingly. In this backdrop if international opinion is with us we could protect the territorial integrity and unity of our nation" (Daily News January 23, 2002).

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 involvement of the only superpower, its major trading partners and the largest donor to Sri Lanka in the peace process.

The UNF leadership managed to secure the support of the U.S. government at a level never achieved before. Richard Armitage, the Deputy Secretary of State, was actively involved and took almost a personal interest in the success of the peace process.<sup>20</sup> The support of the only remaining superpower was important for strategic reasons, as political backing from the United States always plays a role in securing aid from multilateral agencies like the IMF and the World Bank. The United States is also an important trading partner for Sri Lanka. According to newspaper reports at that time Sri Lanka

<sup>20</sup> In the midst of the peace process the author participated in a video conference held at the USIS with the participation of the former US Ambassador to Sri Lanka, Terisita Schaffer. Currently she works for the Centre for Strategic and International Studies in Washington. At this meeting Schaffer confirmed that the April meeting held in US was a tremendous success for Sri Lanka. Although there were only about seventy participants from various US agencies attending the meeting, she said their interest in the peace process was serious.

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 Sri Lanka as a part of a triangle of economic growth, with Tamil Nadu and Kerala at the other two corners.

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. Subsequently there were no formal face-to-face negotiations, but discussions continued through Norwegian mediation. The focus of these discussions was an interim arrangement to facilitate relief and rehabilitation efforts in the North-East. The most significant outcome of this process was the proposal for an ISGA that was put forward by the LTTE. The political objective of this proposal was clear: to create a politico-administrative structure dominated by the LTTE that would have control over funds allocated for the rehabilitation of the North-East. However, the government could not begin discussions on this basis. The president took over three critical ministries in November 2003 and dissolved the parliament in February 2004. The subsequent defeat of the UNP in the April 2004 elections marked the end of the UNF strategy for the time being.

If we survey what the UNF gained through this strategy, the economic achievements stand out. The economy began to revive in 2002, the first year of the peace process, and continued in 2003. Stability created by the ceasefire was a major contributing factor. The UNF's step-by-step approach to negotiations indirectly provided time for the economic revival. Indeed if so called 'core issues' had been tackled at the beginning it could have

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,<sup>21</sup> 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 rotally 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 period. As argued by some analysts, one of the political objectives of the LTTE in entering negotiations was securing international recognition through the removal of the ban in at least some countries.<sup>22</sup>

But the negotiations never reached a stage where the ban on the LTTE could be lifted. In the eyes of the LTTE, the ban was used to justify their exclusion from the Washington meeting. The Tokyo meeting also went ahead despite their protests and refusal to participate. For the LTTE then, the internationalization strategy was much more beneficial to the government than themselves. They suspected that the government was consciously promoting it for several reasons--including securing support for the economy as a means of pressuring the LTTE not to walk away from negotiations, and to secure military assistance if the negotiations broke down. More specifically, the LTTE was concerned about the role played by United States with its international agenda against terrorism.<sup>23</sup>

The experience of the last round of negotiations does not mean the LTTE has abandoned its strategy of lobbying and securing support internationally. However,

21 It is important to note that increase in paddy production was largely due to increase production in the North-East.

22 See Sumanasiri Liyanage (2003) "The LTTE's pull out from the peace talks-a comment," *Poity*, Vol. 1, No. 3. Sumanasiri Liyanage identifies four main political objectives of LTTE in entering the negotiation process. "1. Gaining international recognition and revoking the proscription of the organization in USA, UK, Canada and Australia. 2. Gaining access to government-controlled areas in Jaffna under the normalization clause of the MOU. 3. Freedom of movement at sea without any ban on fishing. 4. Full control of the rehabilitation process in the Northern and Eastern Provinces."

23 During the negotiations there was much speculation about the expansion of defense-related links between U.S. and Sri Lanka. There is evidence to show there were organizations and individuals extremely interested in progress in this direction. As examples see, "All the world is on the same side," *Daily News*, 11 November 2002, keynote address at Asia-Pacific Centre for Security Studies in Honolulu, by Minister Milinda Moragoda. In this speech Minister Moragoda virtually accepts the hegemony of the U.S. in the unipolar world. This speech created a wide-ranging debate in Sri Lanka with the participation of the president as well. For a U.S.-position in helping Sri Lanka, see Dana Robert Dillon, "Helping Sri Lanka Secure a New Beginning," Executive Memorandum #830. The Heritage Foundation, 30 August 2002. <http://www.heritage.org/Research/AsiaandthePacific/EM830.cfm>. On the other side, commentators sympathetic to the LTTE's political agenda were wary of increasing military links between U.S. and Sri Lanka. See for example, Dharmarathnam "Taraki" Swamii, "Does US government have strategic interests in Sri Lanka? If so, what are they?" *Daily Mirror*, 29 September 2004.

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 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 donor support got trapped in the politics of the peace process.

Finally, the biggest failure of the UNF strategy was their defeat in the 2004 elections. It was this defeat that marked the virtual end of the UNF strategy. How did this strategy, which had the support of so many donors, international and local non-governmental organizations (NGOs), and conflict resolution experts, not get the

support of the southern electorate? In asking this question we must remember that the UNF went to the electorate only two years after a significant electoral victory. In addition, they stood to gain in the election campaign because of the undemocratic actions of the president. But this was not to be. We shall turn to these issues in the last section of this report.

## 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 were 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 an extremist Sinhala Buddhist ideology. As shown by several studies,<sup>24</sup>

<sup>24</sup> Kumari Jayawardena is a researcher that has continuously explored this theme in her work. See for example, Jayawardena Kumari (1985) *Ethnic and Class Conflicts in Sri Lanka*, Centre for Social Analysis, Jayawardena Kumari (2000) *Nobodies to Somebodies. The Rise of Colonial Bourgeoisie in Sri Lanka* (Social Scientists Association, Colombo).



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.<sup>25</sup>

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 politics. Often they are a less influential factor than other concerns. Although the ruling political class always included representatives with business interests, they also had to rule the country with representatives of many other social groups. Hence business leaders could not always have their own way when it came to politics, thereby limiting their ability to influence a solution to the conflict.<sup>26</sup>

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

capitalist class. Deregulation of various sectors of the economy, privatization of the state-owned sector, and intensification of the linkages with global capitalism created these new avenues. As far as the capitalist class was concerned, what dominated during the post-1977 period was the creation of new opportunities that helped achieve the respectable 4-5 percent growth discussed above and benefited the bourgeoisie.

This trend was much stronger than any negative impact the war had on the accumulation process. Most probably the biggest negative impact would have been the loss of the market in the North for consumer goods. But this would have been compensated by new opportunities generated by the post-1977 liberalized economic regime. In addition the war itself would have created new opportunities for a small section of the capitalist elite. In short, compared to the pre-1977 period, the capitalist classes were having it good due to liberalization, and there was no reason for them to be active in the politics of peace.

All this changed with the economic crisis of 2000-2001. With the deterioration of macroeconomic conditions and economic recession, at last the war affected the interests of the bourgeoisie. Some of the existing avenues of accumulation were blocked, a large number of small businesses closed, the stock market was affected, and any prospects of foreign investment coming into Sri Lanka diminished.

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

<sup>25</sup> These are areas that need much more systematic research. There is a lot of evidence that can be systematically collected and analyzed. Many of the modern Sinhala Buddhist organizations such as All Ceylon Buddhist Congress, Young Men's Buddhist Association, Sinhala Veera Vihana, etc., are middle class organizations that attract representatives of the business community. All of them have been opposed to the peace process.

<sup>26</sup> Some of the studies that have looked at the nature of the Sri Lankan elite in general, and the political elite in particular, confirm the multi-class character of the political class. See T. Coomaraswamy, (1988) "Parliamentary Representation in Sri Lanka, 1931-36," unpublished Ph.D. thesis, Institute of Development Studies, University of Sussex; M.R. Singer (1964) *The Emerging Elite, A Study of Political Leadership in Ceylon* (MIT Press, Cambridge, Massachusetts).

differed in several ways. First, there was a strong representation of business organizations representing the interest 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 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 of Sri Lanka, Ceylon National Chamber of Industries, Employer's Federation of Ceylon, Exporters Association of Sri Lanka, Sri Lanka Banks 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 the peace process was a logical development to the donors' new orientation. Indeed,

some of the business initiatives for peace were supported by donors.<sup>27</sup>

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 UNF. This support would have been supplemented with much more tangible material support for the UNF's election campaign. These activities continued after the CFA was signed and negotiations began.

When the post-2001 arrangements were threatening 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 UNF government began to unravel. Private-sector groups made several efforts at lobbying 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 UNF government and demonstrated the limits of the business community's influence even in the context of a liberalized economy.

27

There is a need to do more empirical work to see how important donor support was. One of the business initiatives that clearly received donor support was Sri Lanka First. However, one must remember that big business commands significant wealth and they are ready to spend money if it can positively affect their interests. For example during elections they support political parties to ensure their interests are safeguarded. Hence, it is quite likely that they used some of their own funds for these activities without solely relying on donors.



### 3. Politics of Donor Countries

---

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.<sup>28</sup>

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.

As a result the UNF strategy received wholehearted support from most major donor countries. The basic strategy and ideology underpinning the UNF strategy fit well with the donor agendas of ensuring security and stability and promoting liberal capitalism. As argued by some, this is the key objective behind donors' newfound interest in conflicts. It has merged the two fields of development and security within development assistance.<sup>29</sup>

Although there were differences among donor countries especially with regard to the LTTE, these differences should be placed in context. These differences amounted

to divergences in emphasis within the ideological framework of "liberal peace." 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.

In order to understand the near unanimity among donor countries on this issue it is important to compare it with the position of another important external player in Sri Lanka's conflict - India. India is a country outside the donor group, but the position taken by India is important for ensuring durable peace in Sri Lanka.

Before the Norwegians came on the scene and the UNF government's policy of internationalization took root, India was a key external player in the conflict. As is customary in international relations, statements from India during the peace process always welcomed the attempt to find a negotiated settlement to the conflict. However, there were many indicators to show that India was much more suspicious of the LTTE's intentions. Therefore India's position differed from the near unanimity donor countries showed in endorsing the UNF strategy.

Of course this approval by most donors does not mean that there were no debates or discussions about various aspects of the entire UNF strategy. The author himself had opportunities to be engaged in these debates; however, they did not result in any significant policy shifts or impact greatly on the approach taken either by the LTTE or the GoSL.

---

<sup>28</sup> For discussion on aid flows after 1977, see Gunnar M. Sorbo et al. (1987) Sri Lanka, Country Study and Norwegian Aid Review (Centre for Development Studies, University of Bergen) and Ronald J. Herring (2001) "Making Ethnic Conflict, The Civil War in Sri Lanka," in Esmen, Milton J., Ronald J. Herring, (eds.) *Carrot and Sticks, and Ethnic Conflict: Rethinking Development Assistance* (University of Michigan Press, Ann Arbor).

<sup>29</sup> See Mark Duffield (2001) *Global Governance and New Wars* (Zed Books, London) for an excellent elaboration of this thesis.



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 armed groups in the aftermath of 9/11 was a key factor influencing this opinion. The other important issue was the U.S. relationship with India. For many reasons India is the most important country in the region for the United States, and its position toward the LTTE reflected that relationship. Finally, there was the ban imposed on the LTTE by the United States, something 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. spokespersons 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 conditionalities based on liberal principles much 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 aimed specifically at the LTTE. Among them were ones that related to the participation of a Muslim delegation in negotiations, progress toward a final settlement on principles of 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 U.N. Security Council.<sup>30</sup>

In contrast to the United States, there were several donor countries that took a more open attitude toward 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 argued needed to be applied equally to both the government and 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 were not so great as to bring about serious differences within donor countries.<sup>31</sup> The UNF strategy of peace and promoting a liberal economy provided an environment where they could agree more than disagree.

The best indicator of the unanimous support that the UNF strategy received from donors is the increased amount of aid received during these years. As shown by Central Bank data, the total amount of aid increased from Rs. 17.2 million in 2002 to Rs. 61.2 million in 2003—an increase of nearly 350 percent.

30 See "Sri Lanka, Living in Fear, Child soldiers and Tamil Tigers in Sri Lanka," Human Rights Watch, Vol. 16, No.13(C), November 2004.

31 There are many examples of such divergences, especially between European countries and the United States, in different parts of the world. Probably the best example is the invasion and occupation of Iraq.

32 Central Bank of Sri Lanka, Annual Report 2003.

**Table 5. Selected indicators of foreign aid (In Rs.million)**

	2000	%	2001	%	2002	%	2003	%
Loans	10070	66.2	19396	77.9	10113	58.8	53213	87.0
Grants	5145	33.8	5500	22.1	7079	41.2	7956	13.0
Total	15215	100.0	24896	100.0	17192	100.0	61169	100.0
Foreign Debt (% GDP)	43.1		45.3		45.6		47.9	
Deficit financing Foreign Sources (% GDP)	0.4		1.4		0.5		2.9	

Source: Annual Reports of the Central Bank, 2000-2003

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.<sup>32</sup>

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.<sup>33</sup> The table below provides data for those donors with a net positive flow in favor of Sri Lanka. It also shows Sri Lanka's overwhelming dependence on three donors during these years-- the ADB, Japan, and International Development Association (IDA) loans from the World Bank.<sup>34</sup>

As much as the increased flow of aid helped in the management of the economy, the peace process also helped the government secure donor commitments for many projects related to the normal process of economic development. For example, a preliminary analysis of the projects for which aid was committed in 2003 shows that only 15 of the 62 projects were directly related to peace or had provisions for work in the North-East.<sup>35</sup> The other 47 covered subjects related to the normal process of development.

<sup>33</sup> During the years 2000-2003 there was a net outflow from Sri Lanka in the case of the following donors: Canada, Denmark, France, International Bank for Reconstruction and Development, Italy, Netherlands (2000 only), UK and U.S.

<sup>34</sup> It is also important to note that during this period Sri Lanka benefited from loan agreements from India and China.

<sup>35</sup> Data from the External Resources Department, Ministry of Finance.

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

	2000	%	2001	%	2002	%	2003	%
ADB	4763	25.0	5777	26.9	12391	41.6	17548	28.7
Australia	257	1.3	216	1.0	1515	5.1	1810	3.0
Germany	839	4.4	1633	7.6	20.0	0.1	630	1.0
IDA	2236	11.7	677	3.2	5663	19.0	15950	26.1
IFAD	231	1.2	137	0.6	205	0.7	198	0.3
Japan	10179	53.4	12146	56.6	8596	28.8	23298	38.1
Netherlands			427	2.0	626	2.1	880	1.4
Norway	325	1.7	298	1.4	499	1.7	435	0.7
Sweden	241	1.3	155	0.7	285	1.0	389	0.6
Total	19071	100.0	21466	100.0	29800	100.0	61138	100.0

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 assistance from other donors and encourage foreign investors.

On the other side of the significant support that the UNF received are the interests of various donors. The support in the form of aid flows was not only an endorsement of UNF policies, but also reflection of the congruence between the UNF strategy and donor interests. At a general level, these common interests are signified by the twin objectives of security and promotion of a market economy. At a much more specific level, the UNF strategy catered to the different interests of each donor.

The primary aim for the three big multilaterals, the IMF, the World Bank, and the ADB, has been promoting a market economy or capitalism. The IMF's budgetary support was conditional on the government carrying out stabilization measures and structural reforms. The World Bank and ADB have been involved in policy-based lending for the same purpose. The economic agenda of the UNF promised to carry this forward systematically. The meeting of minds between the government and multilateral agencies was such that in a rare departure from the normal tradition, the country strategy paper of the World Bank openly praised the regime in power. For example, the opening page of

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 first in Asia where Japan had a greater degree of experience and interests. 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, and (as part of the economic reforms) was pursuing a free trade agreement with the UNF. These developments and an expansion of U.S. development aid post-9/11, rendered Sri Lanka under the UNF 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 where 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. The result has been for the EU to take steps to create "Fortress Europe" from which unwanted migrants and refugees are barred.

Sri Lanka's civil war has generated many refugees who have sought asylum status in Europe. While some have received the right to settle in these countries, many European countries repatriated failed asylum seekers even during the war. For some time European countries have been seeking a formal agreement with Sri Lanka in order to regularize this 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. This took place during the visit of the Sri Lankan foreign minister to Brussels in July 2002.

This survey of the politics of donor countries during the UNF regime shows a period of remarkable agreement between the donors and the political class of Sri Lanka (as represented by the UNF). There was much hope that Sri Lanka was on the path to peace and stability with the blessing of the donors. However, this was a short-lived euphoria. After two years of bliss, everybody recognized that the Sri Lankan electorate had different ideas about what had been going on.



## 4. Defeat of the UNF

---

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 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 election, the entire strategy of peace efforts and economic reforms would have been strengthened and advanced to the next level. 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 effort. As usual the

media was unanimous in supporting a military solution and there were many public meetings in support of the same. Recruitment by the army attracted many young men and women.

The 1994 election was a turning point in this regard. President Kumaratunge for the first time campaigned on a platform of negotiations and won. This was repeated in 2001, this time by Ranil Wickremasinghe. This is historically important, as they are the first elections (since voting began in 1931) where the two major political parties campaigned for reforming the centralized post-colonial state and won.

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). This was highest when the UNF and LTTE actually conducted several rounds of face-to-face negotiations. In a national sample it would have been difficult to maintain such high support if not for the agreement of a large percentage of Sinhalese. This data also indicated that there had been a sizeable shift in opinion among the majority community away from supporting a military solution toward agreeing with a negotiated settlement.

Hence, in order to understand the UNF defeat one must look beyond the dynamics of the peace process. Certainly the political fallout caused by the economic reform program was a contributing factor. Every economic reform involves reconstituting the relationship between the state and social groups affected by the reforms. Reactions obviously reflect how the reforms either negatively or positively affected particular social



classes. The politics of successful reform involves managing the negative fallout peacefully while retaining the support of the population as 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's 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 the area of 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 that the politics of carrying out each of these reforms entail overcoming the resistance of fairly well organized and entrenched interest groups, classes, and ideologies.

Reformers of state enterprises have to tackle the resistance of people employed in these enterprises.

Salariated 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.<sup>36</sup>

Even during the post-1977 period this class has expanded. This is partly due to the political difficulties facing large-scale retrenchment in the public sector, continuous dependence on the state sector for various aspects of services, and the dominance of patronage politics within the political class that continues to use the state as a means of employing their supporters.

The organized working class is one that has expanded due to the impact of liberal economic policies, as the expansion of various sectors of the economy increased their absolute numbers. Although it doesn't cover a significant section of the new working class, Sri Lanka has a trade union movement for critical sectors like plantations, civil service, state enterprises (including the financial sector), and sections of the private sector. Some of the unions have close affiliation with political parties, allowing them to form an important interest group in political bargaining. Indeed, political parties who come to rule the country often depend on the support of these trade unions in their political battles.

Developing market mechanisms in land and water involves challenging a long-held policy of subsidizing and protecting the paddy-producing small holds farmer.

This is an ideology that has been a principal element in the formation of the highly centralized post-colonial Sri

36 For background material of this analysis, see Gunasinghe Newton (1996) 'A Sociological Comment on the Political Transformations in 1956 and the Resultant

Socio-Political Processes and Land Reform, *Class Structure and the State*, in Perera Sasanka (ed), *Newton Gunasinghe: Selected Essays* (Social Scientists Association, Colombo), Jayawardena Kumari (2000) *Nobodies to Somebodies. The Rise of Colonial Bourgeoisie in Sri Lanka* (Social Scientists Association and Sanjaya Books, Colombo), Jayadeva Uyangoda (1999) 'Post-Independence Social Movements', in (ed) W/D Lakshman and C.A. Tisdell, *Facets of Development of Sri Lanka since Independence: Socio-Political, Economic, Scientific and Cultural* (University of Queensland, Brisbane), Sunil Bastian (2003), 'The political economy of Electoral Reform, Proportional Representation of Sri Lanka', in Sunil Bastian and Robin Luckham (ed), *Can Democracy be Designed?* (Zed Books, London).

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. Under such circumstances one can understand how sustaining the support of the Sinhala electorate would certainly be a formidable task.

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:

- 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—long enough for the UNP to push its reforms through.
- 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 is 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, never mind economic, regime of the day. Thus the ruling classes were left to pursue reforms as they wished.

- 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. As a result, the new government was popular enough to carry out economic reforms.

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. However, the UNF did so in far less favorable circumstances and, not surprisingly, paid the price.

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,



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."<sup>37</sup>

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 absolute poverty. It goes against a social trend established since Independence, where the power of the Westernized colonial bourgeoisie was challenged and various policy measures adopted to break the monopoly of power of this tiny minority. As we have argued, the real beneficiaries of this were the intermediate classes. But it established an ethos and a demand for social justice that still influence political battles.

Growing inequality also has a significant influence on overall perceptions regarding development models, as it strengthens the perception of injustice. When inequality is prevalent, both socially and regionally, as is the case of Sri Lanka, the perception of the dominance of an unjust model of development is stronger.

Table 7. Indicators of regional inequality		
Province	Share of Households in Poverty (1995/96)	Share of GDP (2000)
Western	12.2%	49.4%
North-Western	30.4%	10.4%
Central	35.4%	9.9%
Southern	32.5%	9.3%
Sabaragamuwa	40.0%	6.7%
Eastern	n.a.	4.5%
Uva	33.9%	4.0%
North-Central	26.1%	3.8%
Northern	n.a.	2.1%
Sri Lanka	26.7%	100.0

Source: White Paper presented by the GoSL to the Oslo meeting, 25 November 2002

Another contradiction of liberal capitalism that has had wide-ranging social repercussions was the status of the smallholder peasantry who were growing paddy. As we have argued above, protecting this class has been one of the basic principles of the post-colonial Sri Lankan state. However for many years there has been a gradual deterioration of the viability of smallholder paddy and, as a result, the living conditions of those engaged in that kind of agriculture.<sup>38</sup> Politically they form the largest section of the electorate.

Finally, the UNF tried to undertake its extensive reforms in a society that was experiencing the impacts of the 2001 economic recession. The high cost of living, loss of employment due to the closure of

37 Central Bank of Sri Lanka, Annual Report 2003. This survey also did not cover Killinochchi, Mannar and Mullativu 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 as 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 strategy did not have any significant policy package to tackle social issues. Since the planners and 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 growth process and improve certain support services so that the poor could benefit.

Basic assumptions of the economic vision precluded any 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 reports gave the impression of being written by consultants devoid of any knowledge of Sri Lankan history or any clue 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 Samurthi 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 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 subscribed to this strategy while carrying out reforms.<sup>39</sup> The thrust of the UNF strategy was to tighten these programs rather than to think of any new innovations. Therefore, while the reform programs alienated large sections of the population, there was very little to maintain their support. This fed into a widely held perception that most of the reforms benefited only big business. Specific policies such as the tax amnesty confirmed this impression and provided ammunition for the critics.

The Poverty Reduction Strategy Paper (PRSP), the poverty-related component of the economic reform program, put forward when the UNF was in power, could never play this political role. Right from the beginning, the PRSP was identified with donors and therefore lacked political legitimacy. It was criticized for what it actually is—an adjunct to the politically controversial reforms that donors were trying to push. In essence, the substance of the PRSP is comprised of the

---

<sup>39</sup> See Mick Moore (1997) "Leading the Left to the Right: Populist Coalitions and Economic Reform," World Development, Vol.25, No.7 for a discussion of the political strategy for economic reforms of the PA.

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.<sup>40</sup>

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 elections. After only two years at the helm, Ranil Wickremasinghe had led the UNP to a worse electoral defeat than the one that occurred after 17 years of repressive UNP rule.

	2001	2004	+/-
Colombo	49.7	40.3	-9.4
Gampaha	42.3	35.7	-6.7
Kalutara	43.4	35.8	-7.6
Galle	42.2	36.6	-5.6
Marara	40.4	33.0	-7.4
Hambantota	38.2	33.3	-4.9
Maralle	47.1	45.2	-1.9
Kandy	49.3	46.6	-2.7
N/Eliya	62.6	50.3	-12.4
Kurunegala	46.3	40.9	-5.5
Puttalam	48.2	43.4	-4.7
Polonnaruwa	44.9	38.2	-6.7
Anuradhapura	43.5	37.8	-5.8
Moneragala	39.7	34.7	-5.0
Badulla	50.2	45.4	-4.8
Ratnapura	43.7	39.5	-4.2
Kegalle	46.8	41.8	-5.1
Jaffna	8.2	0.0	-8.2
Vanni	26.0	22.3	-3.7
Batticaloa	11.8	2.4	-9.3
Amparai	19.7	13.6	-6.0
Trincomalee	37.1	8.2	-28.9
Total	43.2	35.8	-7.4

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

40

For a critique of Sri Lanka's PRSP see Debayani Kar (2003) The IMF-World Bank Plan for Sri Lanka: Will it Help or Hinder South Asian Success? (Centre for Economic and Policy Research, Washington D.C.). For a critique by a civil society network representing more 125 trade unions, NGOs, and religious organizations, see a statement by Alliance for Protection of Natural Resources and Human Rights. <http://www.geosites.com/monlarslk/Statements3.htm>.

## 5. Implications for International Donors

---

### 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 ruling class was ready to lift the ban on the LTTE, accept that there were two armies controlling different parts of the country, sign a ceasefire agreement, and begin negotiations.

The LTTE's objectives were 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 UNF leadership achieved a ceasefire agreement soon after it came to power. On this basis several rounds of negotiations were held. But the negotiations broke down

when the LTTE was not invited to the Washington meeting. In the meantime, the economic reform program moved forward.

However, as we have argued, the economic reform program caused a political fallout by alienating large sections of the Sinhala population. Eventually this led to the UNF's defeat in the 2004 elections.

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 this as the essence of peace. They were equally supportive of the economic agenda as it favored markets, private sector development, and further liberalization of the economy. Even donor policies that have poverty alleviation as their focus are conceptualized within this economic ideology.

Among donors, the only key difference was in how best to deal with the LTTE. Here the country that stood out most was the United States. This was primarily because of American strategic security interests in the post-9/11 period and its legal ban on the LTTE. The United States was also more skeptical about the LTTE's attitude toward negotiations, and applied pressure on the organization to prove its bona fides, principally by making use of conditions stipulated in the Tokyo declaration.

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 UNF, 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.

This was either because they were unable to influence these processes or because it was not in their strategic interests to do more than they were already doing. 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 and in the end sent thousands of its troops to Sri Lanka. This is not to argue that this approach was correct. But it shows that India intervened because it was in its strategic interests to do so. Many donor countries have behaved like that in other conflict situations, whether it be European intervention in the Balkans or the United States in parts of the world where their interests are perceived to be threatened. Whether we like it or not, these interests are what drive the policies of most countries.

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. The LTTE will try to extend its control over the North-East. 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 co-operation with India. The U.S. will also be an important economic partner for Sri Lanka. Its position regarding the LTTE is unlikely to change.
- 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. Japan is also likely to work closely with India, especially as both countries are vying for a permanent position on the U.N. Security Council.
- As it is now, multilateral donors, the United States, Japan, and India will be the largest sources of foreign aid and external influence. These are the agencies and countries that can wield influence in Sri Lanka.
- This leaves many other donor countries providing relatively small amounts of aid. They are the ones who will promote debates and discussions about the best approach donors should take but they are unlikely to contribute to any serious policy shift.
- Norway will continue to occupy the unique position of facilitator and mediator but her principal concern will be how best to promote a deal between the GoSL and the LTTE.



## BUILDING A SOCIAL MOVEMENT TOWARD PEACE

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.<sup>41</sup> 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:

- 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.
- 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.
- 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.
- This does not mean there have been no shifts or changes in the situation. If one has a feeling for the history of modern Sri Lanka, its polity has evolved significantly in accepting some of the fundamental notions that are necessary for a solution. For example, the notion of devolution and the need to reform the state is accepted by the two main parties and a significant section of the population.
- This is a significant change. But it is important to remember that this idea only entered mainstream

politics in 1987 with the signing of the Indo-Lanka Accord. This is a very short period of time if one considers that the history of the modern Sri Lankan state goes back to the middle of the 19th century under British colonialism.

- Keeping these historical processes in mind, the task is to find and create a political space that promotes 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.

Within this political agenda 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 needs to be strengthened.
 

This is necessary to improve the image and legitimacy of the Sri Lanka Monitoring Mission, especially in the eyes of the majority community. Many have lobbied for a strong human rights mechanism to run parallel to the CFA. This mechanism should cover the behavior of both the LTTE and the Sri Lanka Armed Forces.
2. *Resumption of negotiations.* Every effort should be made to resume negotiations. Although there are contacts between the LTTE and GoSL even without formal negotiations, they lack legitimacy among the majority community. In fact, some of these efforts are viewed as underhanded efforts to support the LTTE.

41 Much of this debate took place through websites, in the journal Polity and Sinhala media like Navaya.



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 reforms so that the peace process is not undermined. This is important as there was little understanding of the relationship between the politics of economic reform and the politics of the peace process during the last round of negotiations. If these principles are taken seriously there is a
6. *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. *During the last round of negotiations, investments to improve livelihoods of the population in the North-East unfortunately became trapped in the politics of trying to get a deal between the LTTE and GoSL. This link should be broken.* The population in the North-East has suffered enough without subjecting them to the political objectives of the Colombo elite or the armed LTTE. Therefore, there must be greater effort to channel funds to the North-East and not let them get trapped in the politics of the Track 1 peace process.
8. *It is also important to remember that there are many areas of intervention that can be undertaken without waiting for negotiations to succeed.* For example, much can be done

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 UNF 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 UNF'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 usual 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 a group closely associated with the president is keen to begin the negotiation process, several obstacles remain. They include: a lack of trust between the UPFA leadership and the LTTE; internal contradictions of the ruling regime; uncertainties in the East; and the LTTE's position on the ISGA.

These factors have made managing the economy more difficult. The UNF is clearly hoping to wrestle control of the presidency and parliament so it can continue to re-implement the policies that it began. This could even include giving the LTTE interim control of the North-East. Donors, if they work within the same framework as before, could be supporting these steps.

Given the present balance of political forces in the South, the result of such an effort could be large-scale instability in the South. The more extremist sections in the South will capitalize on the contradictions of the peace process and economic reforms. In such a context, the UNF could return to its authoritarian politics of the 1977 to 1989 period. The worst scenario is that donors will support the twin strategy of extending the authoritarian rule of the LTTE in the North-East and the economic agenda in the South despite the repression and instability of the government.



## Bibliography

---

- Bastian, S. (1984) *Ethnic conflict and university admission, in Ethnicity and Social Change in Sri Lanka* (Social Scientists Association, Colombo)
- Bastian, S. (2003) "The Political Economy of Electoral Reform, Proportional Representation of Sri Lanka," in Sunil Bastian, Robin Luckham (ed), *Can Democracy be Designed?* (Zed Books, London).
- Centre for Policy Alternatives (2003) "Peace Confidence Index: Top-Line Results," *Social Indicator* (Colombo, January 2003).
- Coomaraswamy, T. (1988) "Parliamentary Representation in Sri Lanka, 1931-36," unpublished Ph.D. thesis, Institute of Development Studies, University of Sussex.
- Duffield, M. (2001) *Global Governance and New Wars* (Zed Books, London).
- Dunham, D. and Jayasuriya, S. (1998) "Economic crisis, poverty and war in contemporary Sri Lanka: On ostriches and tinder boxes," *Economic and Political Weekly* Vol. 33, No.49.
- Gilles, D. (1992) "Canadian Aid, Human Rights and Conflict in Sri Lanka", in Robert Miller (ed), *Aid as Peacemaker* (Carleton University Press, Ottawa).
- Grobar, L.M., Gunasekaram, S. (2001) "The economic effects of Sri Lanka's civil war", *Economic Development and Cultural Change*, Vol. 41, No. 2.
- Gunasinghe, N. (1996) "The open economy and its impact on ethnic relations in Sri Lanka," (ed) Sasanka Perera, Newton Gunasinghe, *Selected essays* (Social Scientists Association, Colombo).
- Herring, R. J. (2003) "Making ethnic conflict: The civil war in Sri Lanka," in (eds) Milton J. Esman, Ronald J. Herring, *Carrots, Sticks and Ethnic Conflict, Rethinking Development Assistance* (University of Michigan Press).
- Jayawardena, K. (2000) *Nobodies to Somebodies, The Rise of Colonial Bourgeoisie in Sri Lanka* (Social Scientists Association and Sanjaya Books, Colombo).
- Jenne, E. K. (2003) "Sri Lanka: A Fragmented State," in Robert I. Rotberg (ed.) *State Failure and State Weakness in a Time of Terror* (Brookings Institution Press, Washington, D.C.)
- Kar, D. (2003) *The IMF-World Bank Plan for Sri Lanka: Will it Help or Hinder South Asian Success?* (Centre for Economic and Policy Research, Washington D.C.).
- Kelegama, S. (2001) "Sri Lankan Economy in Turbulent Times, Budget 2001 and IMF package," *Economic and Political Weekly*, July 14, 2001.
- Kelegama, S. (2004) "Economic dividend of the post-war period in Sri Lanka: Problems and Prospects." Paper prepared for the UNU-WIDER conference 'Making Peace Work', Helsinki, 4-5 June 2004.

- Malik, R. (1998) *Development, ethnicity and human rights in Asia*. (Sage, New Delhi).
- Moore, M. (1990) "Economic liberalisation versus political pluralism in Sri Lanka," *Modern Asian Studies*, Vol. 24, No. 1.
- Moore, M (1997) "Leading the Left to the Right: Populist Coalitions and Economic Reform," *World Development* Vol.25, No.7
- Muscari, R. J. (2002) *Investing in peace, How development assistance can prevent or promote conflict* (M.E. Sharpe, New York).
- Goodhand, J and B. Klem, with D. Fonseka, S.I. Kethaponcalan and S. Sardesai (2005) "Aid, Conflict, and Peacebuilding in Sri Lanka, 2000-2005." A report prepared for the World Bank, DFID, the Netherlands Embassy and SIDA.
- Gunasinghe N. (1996) "A Sociological Comment on the Political Transformations in 1956 and the Resultant Socio-Political Processes and Land Reform, Class Structure and the State," in Perera Sasanka (ed), *Newton Gunasinghe: Selected Essays* (Social Scientists Association, Colombo).
- Nisha, A, Jayasuriya, S. and Kelegama, S. (2000) *The economic costs of war* (Institute of Policy Studies, Colombo)
- Nissan, E. (1996) Sri Lanka: A Bitter Harvest (Minority Rights Group International, London).
- Peebles, P (1990) "Colonization and ethnic conflict in the dry zone of Sri Lanka" *The Journal of Asian Studies*, Vol. 49, No.1.
- Peiris, G.H. (1991) "An appraisal of the concept of a traditional Tamil homeland in Sri Lanka", *Ethnic Studies Report*, Vol.9, No.1.
- Rajasingham-Senanayake, D. (1999) "The Danger of Devolution: The Hidden Economics of armed Conflict," in Rotberg (ed), *Creating Peace in Sri Lanka* (Brookings Institution Press, Washington D.C.).
- Shastri, A. (1990) "The Material Basis for Separatism: The Eelam movement in Sri Lanka," *Journal of Asian Studies*, Vol. 49.
- Singer, M. R. (1964) *The Emerging Elite, A Study of Political Leadership in Ceylon* (MIT Press, Cambridge, Massachusetts).
- Sorbo, G. M. et al (1987) *Sri Lanka, Country Study and Norwegian Aid Review* (Centre for Development Studies, University of Bergen).
- Tennekoon, S. (1988) "Rituals of Development: The Accelerated Mahaweli Development Programme of Sri Lanka," *American Anthropologist*, Vol.15.
- Uyangoda, J. (1999) "Post-Independence Social Movements," in (ed) W.D.Lakshman and C.A.Tisdell, *Facets of Development of Sri Lanka since Independence: Socio-Political, Economic, Scientific and Cultural* (University of Queensland, Brisbane).
- Uyangoda, J. (2004), "Peace Warch", Polity, Vol.1, No.3.
- Wilson, A.J. (1980), *The Gaullist System in Asia, The Constitution of Sri Lanka* (1978) (Macmillan Press, London).
- World Bank (2003) *Sri Lanka, Country Assistance Strategy of the World Bank Group 2003-2006* (The World Bank Group, Colombo).









Award winning photographs by Annurudha Lokuhaparaechchi, Dominic Sansoni and Gemunu Amarasinghe