

# **SRI LANKA: STRATEGIC POLICY ASSESSMENT**

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**ACRONYMS**

ADB	Asia Development Bank
APRC	All Party Representative Committee
ASEAN	Association of South East Asian Nations
ASPI	All Share Price Index
BDG	Bilateral Donor Group
BTF	British Tamil Forum
CBO	Community Based Organisation
CBSL	Central Bank of Sri Lanka
CCHA	Coordination Committee for Humanitarian Assistance
CCPI	Colombo Consumer Price Index
CCPI (N)	Colombo Consumer Price Index (New)
CEPA	Centre for Poverty Analysis
CHA	Consortium for Humanitarian Affairs
CFA	Ceasefire Agreement
CFS	Consumer Finance and Socio-Economic Survey
CHAP	Common Humanitarian Action Plan
COI	Commission of Inquiry to Investigate and Inquire into Serious Violations of Human Rights
CORE	Connecting Regional Economies
CPA	Centre for Policy Alternatives
CSIS	Centre for Strategic and International Studies
CWC	Ceylon Worker's Congress
DFID	Department for International Development
DNA	Democratic National Alliance
ECHO	Humanitarian Aid department of the European Commission (formerly European Community Humanitarian Aid Office)
EU	European Union
GDP	Gross Domestic Product
GoSL	Government of Sri Lanka
GTF	Global Tamil Forum
GTZ	Deutsche Gesellschaft für Technische Zusammenarbeit
GSP	General System of Preferences
FDI	Foreign Direct Investment
HIES	Household Income and Expenditure Survey
ICG	International Crisis Group
ICRC	International Committee of the Red Cross
IDP	Internally Displaced Person
IFRC	International Federation of the Red Cross
IHL	International Humanitarian Law
IHRL	International Human Rights Law
IIGEP	International Group of Eminent Persons
IMF	International Monetary Fund
INGO	International Non-Governmental Organisation
JVP	Janatha Vimukthi Peramuna
JHU	Jathika Hela Urumaya
LLRC	Lessons Learned and Reconciliation Committee
LSSP	Lanka Sama Samaja Party
LTTE	Liberation Tigers of Tamil Eelam
MDGs	Millennium Development Goals
MOU	Memorandum of Understanding
NGO	Non-Governmental Organisation
OCHA	Office for the Coordination of Humanitarian Affairs
ODA	Official Development Assistance

OECD/DAC	Organisation for Economic Cooperation and Development /Development Assistance Committee
PA	People's Alliance
PERC	Public Enterprise Reform Commission
PNG	Persona Non Grata
PR	Proportional Representation
RDS	Rural Development Society
SAARC	South Asian Association for Regional Cooperation
SBA	Stand-By Agreement
SCA	Strategic Conflict Assessment
SPA	Strategic Policy Assessment
SLMC	Sri Lanka Muslim Congress
TGTE	Transnational Government of Tamil Eelam
TMVP	Tamil Makkal Viduthalai Pulikal
TNA	Tamil National Alliance
UN	United Nations
UNF	United National Front
UNHCR	UN High Commission for Refugees
UNHRC	UN Human Rights Council
UNOPS	UN Office for Project Services
UNSC	UN Security Council
UPFA	United People's Freedom Alliance
USAID	United States Agency for International Development

## EXECUTIVE SUMMARY

### Introduction

This Strategic Policy Assessment addresses the following questions:

- What changes have taken place in Sri Lanka's political and economic landscape since 2005?
- How has the nature of, and environment for international assistance changed? In what ways have international policies interacted with Sri Lanka's changing political and economic landscape?
- What are the key drivers of change? What are the risks of a return to large-scale violence in Sri Lanka, and what circumstances would increase or decrease those risks?
- To what extent and in what ways can aid donors effectively contribute to long-term development and the consolidation of peace in Sri Lanka?

### Section One: The Political Landscape

The UPFA's rise to power followed a familiar pattern in which the loss of power by one of the mainstream parties was followed by the other's 'shock therapy' measures, to consolidate and centralise control. Mahinda Rajapaksa mobilised around a nationalist platform and forged a domestic power base through a 'rainbow coalition' of parties and actors. However, the consolidation of power and a military end to the conflict was not an easy or inevitable outcome, as the administration had to contend with internal divisions, an economic crisis in 2008 and growing international pressure to bring the war to an end. The UPFA navigated these hazards by drawing upon nationalism, patronage and securitized development to bind together diverse groupings and deal with potential threats.

The President gained huge popularity through winning the war – there was almost universal relief that the conflict was over and there has been a trend towards improved security throughout the country. However, though the military victory bought the Rajapaksas a great deal of political capital and policy space, it also came at a cost in terms of Sri Lanka's democratic institutions and the likelihood of a just political settlement to the conflict. First, there are strong continuities between wartime and peacetime politics and the powers grasped to win the war have been retained and further centralized to 'win the peace'. Second, Sinhala nationalism, largely on the periphery between 1994 and 2004, has once more entered the political mainstream. Nationalism provides the ideological glue that binds the coalition together and limits the potential for a just political settlement as the normative and political climate seem to be no longer conducive for a substantive devolution of power. Third, whilst Sri Lankan politics has always been coloured by dynastic rivalries and clientelism, these appear to have reached new levels under the current administration and have become a primary tool for maintaining political cohesion, dividing opposition and containing threats to power. Fourth, securitized development programmes (development efforts with the explicit or implicit aim of preventing future security threats from emerging) are being rolled out, particularly in the north and east. The goal of such programmes is to secure, incorporate and integrate the north and east politically, socially and economically, to blunt the secessionist impulse and to obviate the need for a political settlement.

Taken together, these shifts have profoundly changed the nature of the state-minority relationship in Sri Lanka, which is reflected in the diminishing spaces and options for minority political parties. Tamil and Muslim parties, notably the TNA and SLMC, are in considerable disarray in this new political landscape. Essentially they are faced with a stark choice in a patronage based political marketplace – of whether to align themselves pragmatically with the current administration in order to access patronage and protection for their constituencies (and there are significant upwards pressures on them to do this) or to consign themselves to opposition, risking long-term exclusion, not to say political irrelevance.

However, the novelty and coherence of the current administration should not be overstated. First, the current administration is following an old political game, drawing upon familiar idioms and tactics to consolidate power. This is not to under-estimate the huge impact of the end of the war, many effects of which are still being played out and on which it is too early to make judgments. Second, the coherence and hegemonic power of this

administration can be overstated – there are various fissiparous tendencies within the coalition and the challenges of maintaining a cohesive unity are likely to grow over time. It is also not inconceivable that the drift towards authoritarianism may also produce countervailing challenges and opposition in the long term. Furthermore, Sinhala nationalism, at its moment of ascendancy, may experience its greatest challenge given the absence of militant Tamil nationalism which historically provided it with a foil. This may partly explain the deteriorating relationship between the government and western actors following the end of the war, as part of a discursive shift from the identification of internal to external enemies.

## **Section Two: The Economic landscape**

Having achieved its first term goals of winning the war and consolidating its parliamentary majority, the UPFA has prioritised economic progress in its second term. To a large extent the government has staked its credibility on rapid economic growth and transformation. Rajapaksa's election manifesto *Mahinda Chintana* opens by invoking a new 'economic war' to be waged, prioritizing two headline targets: doubling per capita income over the next six years and achieving eight percent growth.

The two most important government priorities in economic terms are (i) fast-tracking economic development in the north and east and (ii) infrastructure development in the rest of the country. Although the anti globalisation and anti market reforms language contained in *Mahinda Chintana* I and II suggests a shift away from the market back to the state, in practice there have been strong continuities between this and previous administrations. *Mahinda Chintana* sets out the aim of transforming Sri Lanka into a naval, aviation, commercial energy and knowledge hub. A crucial challenge facing the government – like its predecessors -- will be to deal with the contradictions resulting from the growing prosperity of globally connected sectors of the economy and the persistent poverty of small holder farmers, especially with the incorporation of the war-affected regions of the north and east.

From 2006 there were predictions that the government's military approach to the conflict would prove too expensive, creating severe fiscal pressure, high inflation and a balance of payments crisis. By mid-2008 many of the elements of this scenario had become manifest, with a global financial crisis and heightened international exposure to the war leading to rapid withdrawal of capital from Colombo, including a sharp decline in remittances, exposing inherent structural weaknesses in the economy. However, the crisis was averted as a result of the end of the war and negotiation of a Stand-By Arrangement with the IMF, both of which contributed to a sharp bounce back in the economy. This is reflected in the country's high growth rates and the stock market's position as the best performing in Asia during 2010.

The IMF agreement involves conditions to address structural deficiencies including weaknesses in government finances and the persistent fiscal deficit. However, there remain concerns about the macro-economy, overoptimistic growth projections and shortcomings in economic governance. The internal economic sustainability of the model may be questioned, particularly given that it depends on continued high rates of foreign investment. However, at present, the momentum of pent-up post-war demand, improvement in the security situation, opening of 'new' areas in the north and east, and large infrastructure projects committed and underway are adequate to carry the current level of economic growth forward for the next three years. As in other post-war contexts, there are strong continuities between the wartime and peacetime economy – therefore much of the rural south depends upon military employment, whilst the effects of wartime on institutions and accountability mechanisms, and the reinvigoration of patronage-based politics all influence economic governance and the scope for broad-based growth. Even if the developmental model succeeds, it will generate distinct internal political dynamics based on perceptions of the distribution of its costs and benefits along communal, geographic and other axes of social cleavage.

## **Section Three: International engagement**

Sri Lanka's geopolitical position has evolved considerably and can broadly be characterized as a growing eastwards orientation. For the UNF government the support of western states and donors were central to its

agenda of a negotiated peace and structural reforms. Conversely the UPFA sought to dilute western influence, partly through building closer ties with regional powers and ‘non-traditional’ donors.

The declining influence of the west reflects several global and national trends. First, Sri Lanka has graduated to middle income status and there is a growing focus on integrating with the dynamic economies of south/southeast Asia. Second, there has been an associated power shift at a global level, with Asian powers increasingly using their new economic power to leverage influence and status in regional and global fora. Third, an anti-western discourse has a long history in Sri Lanka, acting as a source of popular mobilisation through the reproduction of anxieties and stereotypes about the west. Fourth, Rajapaska’s initial reliance on nationalist groups to gain power, combined with his scepticism about Norwegian facilitated negotiations meant that from the beginning he was not as western-friendly as the UNF administration. However, the eastwards tilt was less about ideological orientation than pragmatic necessity. By 2008 in the context of an economic crisis and growing (albeit inconsistent) western pressure, the government needed to find new allies in order to fund the war, provide diplomatic cover and subsequently to provide the policy space to consolidate the post-war political order. The combination of western pressure regarding the conduct of the ‘war for peace’ and specifically human rights violations, and the willingness of eastern states including India and China to provide military and financial support for the war, whilst in the main remaining publicly silent on civilian casualties, accentuated the GoSL’s tilt to the east. Geo-strategic rents were maximized by exploiting strategic competition between India and China.

Fifth, the shift eastwards was also related to the administration’s development strategy. An increased reliance on non-traditional donors and commercial loans has enabled the government to create policy space for itself and thus assert ownership over the development agenda. This has involved an emphasis on ‘hardware’ and a declining focus on traditional western donor concerns related to governance, civil society and human rights.

Divisions between donors based on contrasting sets of interests and institutional pressures have become more evident. Broadly one can identify three groups of donors; a small group of ‘likeminded’ western, bilateral donors who have tended to be more critical of the GoSL because of concerns about human rights and the absence of an inclusive political settlement; the ‘partially likeminded’ who tend to have larger aid programmes, have greater disbursement pressures and tend to take a more pragmatic line on engagement with the government; and the ‘unlikeminded’ composed primarily of non-traditional donors who tend to be most respectful of sovereignty and provide most of their funding through government channels, without political conditions attached.

There are strong pressures on donors to work ‘around’ conflict in the sense of avoiding risky or controversial areas of intervention, particularly those which touch on the core dynamics of the conflict including governance, state reform, and human rights. Amongst some of the larger donors there is a tendency to assume that development is automatically an investment in conflict prevention, although the historical lessons of large-scale development efforts in Sri Lanka suggest otherwise. Some donors have deployed various approaches to addressing conflict issues, directly or indirectly, underpinned by different and sometimes contradictory ‘theories of change’. In some areas there is an overlap with government objectives, suggesting that there may be spaces and opportunities to work ‘on’ conflict in low-key, sensitive ways. However, the trends outlined in the political and economic landscape suggest that the leverage of international donors has never been lower and the opportunities for transformational policies and programmes are severely circumscribed.

#### **Section Four: Drivers of change**

In the short term, the major threats identified to Sri Lanka’s political/economic stability and policy outlook are political implosion at the apex or coalition levels or economic crisis. In the medium to long term, instability is likely to arise as a result of the contradictions brought about by the combination of an authoritarian, inward-looking, nationalist political orientation combined with large volumes of foreign investment, greater global integration, and rapid economic growth.

The stability of the present policy environment and domestic political context depends heavily on the continued dominance of the ruling government and the weakness of the main opposition. At the apex, the government’s ability to assert its dominance and function as a coherent executive relates largely to the tight cohesion of the

political elite, comprised mainly of close Rajapaksa family members. The government's ability to pursue a legislative agenda depends on cohesion within the ruling UPFA coalition, which includes a diverse array of parties drawn together largely by the desire to share in the material benefits of political power. Although difficult to decipher the inter-personal relationships within the elite, it is clear that the UPFA coalition will loosen if member parties sense a weakening in the government, or they feel deprived of their due share of its benefits.

Sri Lanka's weak and fragmented parliamentary opposition parties are unlikely in the short term to galvanise the kind of support necessary to pose a serious challenge to the government. The main opposition UNP is in deep disarray with weak leadership, internal discord and widespread demoralisation of its rank-and-file. In contrast, the JVP, has proved to be a more imaginative and nimble opposition party, but its effectiveness and future capacity to pose a viable challenge to the government is limited by its small parliamentary presence and weak electoral base.

Revitalised opposition is likely to depend on changes in opposition leadership and their capacity to harness discontents related to economic issues and a growing sense of moral outrage among core constituencies related to issues such as corruption, the treatment of former opposition candidate Sarath Fonseka, and the abuse of civil liberties or media freedoms. In many ways the foundations for these oppositional platforms are already in place but currently lack political agency for wider mobilisation.

In the short-to-medium term, the key economic drivers of change relate to the recurrence of an economic crisis. As the balance of payments crisis in late-2008 showed, the Sri Lankan economy is vulnerable to crisis from a number of internal and external factors. Internally, the recent crisis highlighted a variety of structural problems in the economy, primarily the high fiscal deficit and the growing debt burden. In the longer term, the economic drivers of change relate to the success of the post-war developmental model. The two key factors to monitor are the sustainability of the model beyond the initial post-war bounce-back, and its distributional consequences in terms of how the costs and benefits are perceived to affect different communities and geographies.

### **Risks of Violent Conflict Resurgence**

How Sri Lanka's war ended, and the legacy it has left, strongly precludes the possibility of a reversion to the same type and scale of violence. Many of the structural circumstances of Sri Lanka's ethnic conflict continue to fester unaddressed in the post-war period. However, the ideological, political, social, and international circumstances that provided the organisational raw materials to transform grievance into insurgency in the 1970s and early 1980s no longer exist and would be extremely difficult to reproduce. While the possibility that isolated, wildcard incidents of violence will occur in the name of the LTTE cannot be ruled out, the chances of a large-scale resurgence are low both because of the exhaustion of the Tamil community and because of heightened surveillance from the military.

However, given the extent of the latent dissatisfaction and alienation within the Tamil community, war-time violence can mutate into other forms of social, criminal or domestic violence. While the possibility of another large-scale armed insurgency in the short term is low, there are four potential flashpoints of violence: tensions relating to the presence of the security forces in the north and east; inter-communal and intra-communal friction; state authoritarianism; and civil-military tensions. Each of these have their own distinct characteristics and dynamics, but all have been shaped by war time structures and remain unresolved or heightened in the current war to peace transition.

## **Section Five: Conclusions and Recommendations**

### **Conclusions**

The above analysis points to the declining influence of western players. One of the chief lessons is the relative autonomy of domestic political elites in decision-making and thus the need to recognize the limited leverage of international actors. Linking aid explicitly to transformational goals – including mediating peace or reforming the state – has had limited or perverse effects, particularly when there is a weak domestic constituency for such



goals. In this context, heavy-handed political conditionalities are unlikely to achieve desired goals and could well have the opposite effect. However, this is not an argument for a retreat into an apolitical and technical comfort zone, in which donors simply attempt to ‘normalize’ relations with the government and avoid controversial issues. The history of aid in Sri Lanka shows that attempts to work ‘around’ conflict have invariably ended up inflaming conflict.

In such a challenging policy environment, donors need to be highly attuned to the nuances of domestic political discourses and shifting coalitions, without allowing themselves to be pulled too far into the quagmire of local politics. This calls for a careful calibration of political and economic instruments and a consideration of coherence between various policy spheres including migration, counter-terrorism, human rights, development aid, military assistance and diplomacy.

## Recommendations

Recommendations are divided into those aimed at the ‘likeminded’ and ‘partially likeminded’ since these two groups are the primary target audience of this report. Finally, a third set of generic recommendations are highlighted for all aid donors.

### *To the likeminded*

After being particularly active during the peace process, this group of donors has declined in importance financially and politically and has found it difficult to position themselves in the ‘post-war’ setting. In spite of their reduced role, these donors can continue to make a contribution to development and conflict reduction issues in three areas. First, as humanitarian and human rights advocates when other larger donors (constrained by questions of access and delivery) are more reluctant to speak out. Second, as funders of more risky, ‘political’ areas of engagement including civil society and human rights. Third, as innovators, influencers and capacity builders within the donor community, particularly on governance and conflict-related issues. The withdrawal of such donors would leave a significant gap in the aid landscape leading to a further attenuation of political space for alternative voices and groups in Sri Lankan society.

### *The partially likeminded*

This group of donors occupy a particularly critical position at the current juncture. They provide significant funding, particularly for programmes in the north and east, and in order to deliver such programmes have developed relatively close relationships at different levels with the administration. This opens up opportunities for dialogue with a government that arguably holds similar objectives to these donors in the areas of poverty eradication, reconstruction and conflict prevention. However, engagement and ‘partnership’ does not amount to writing a blank cheque to the GoSL – large-scale funding without considering issues related to conflict, equitable development and justice is likely to exacerbate the underlying causes of conflict. Therefore, the partially likeminded must *collectively* develop clearer guidelines for how they engage in the north and east, including applying a justice and equity filter across all areas of work. If such a filter were deployed there is space to work on conflict and development issues in the north and east, including in areas related to economic infrastructure and governance, livelihoods, humanitarian and social protection, employment and education. Such a filter needs to constantly review the macro policy environment, as well as make adjustments at the programmatic and project levels.

### *General recommendations*

Greater diversity within the aid landscape and the increased role of ‘non traditional’ donors may be a positive development if it provides new openings and opportunities for domestic actors to learn from and test alternative models. However it also brings new challenges in relation to coordination and the division of labour between aid donors. Western donors may need to consider a smarter division of labour and, to the extent possible, reach out to ‘non-traditional’ donors in relation to issues where there are common interests, particularly with regard to development of the north and east and the division between hardware and software programming.

The availability, quality and analysis of data, particularly in relation to the north and east, are a major limitation. There is a need to develop a much stronger research and data gathering capacity as a wider resource for the aid community.

There are many lessons to be learnt about the international response both to the peace process and the subsequent 'war for peace'. Whilst recognizing that now may not be a good time for another 'lessons learnt' exercise, for accountability and learning purposes there is a need for a 'meta evaluation' of the international role during this period.

Donor communication strategies have been rather limited and risk-averse. There is a need to explore ways of developing mechanisms and fora to ensure better communication between donors and the GoSL. There is also a need to counter more consistently the negative images promoted by the 'unlikeminded' including nationalist groups and the vernacular press.

## INTRODUCTION

This report examines how ground realities in Sri Lanka have radically shifted since the SCA of 2005 and the implications for international actors, particularly aid donors aiming to help consolidate peace and support development processes in the country. The period since the last SCA has seen momentous changes, with rapid shifts from a faltering peace process, back to full scale war and finally the end of the civil war with the victory of government forces over the LTTE in May 2009.

The previous SCA argued that the peace process had failed to transform conflict structures and dynamics.. However, to the surprise of many, the military campaign that followed the peace process, demonstrated far greater energy, vitality and capacity than negotiations to end the war and establish the foundations for a particular version of peace. The political and policy landscape therefore looks very different today from that of 2005, and the primary questions and challenges faced by aid donors are similarly different. This report seeks to explore these changes (and continuities) in the ideological, economic, political and international basis upon which the policy environment and context is based.

The report seeks to address the following core questions:

- What fundamental changes have taken place in Sri Lanka's political and economic landscape, since the last SCA, and particularly since the end of the armed conflict?
- How has the nature of, and environment for international assistance changed? In what ways have international policies interacted with Sri Lanka's changing political and economic landscape?
- In light of the above analysis, what are the key drivers of change? What are the risks of a return to large-scale violence in Sri Lanka, and what circumstances would increase or decrease those risks?
- To what extent and in what ways can aid donors effectively contribute to long-term development and the consolidation of peace in Sri Lanka?

The study is based upon field work which took place between July and December, 2010. The primary research data was generated through some 80 key informant interviews in Colombo, Batticaloa, Ampara, Trincomalee and Jaffna. Informants were selected in order to capture a broad spectrum of views, positions and levels, including representatives from the government and opposition parties, academic institutions, the media, civil society, international donors and aid agencies, and the diplomatic community. Due to time and access constraints, country-wide coverage was not possible, but the empirical work was supplemented by an extensive perusal of relevant academic literature, press archives, opinion polls and economic statistical material.

The report aims to cover a wide-ranging and highly contested set of issues. The questions that it poses are difficult ones to answer, firstly because it is methodologically complex – as causal relationships are inherently difficult to establish in the social sciences – and secondly because such issues are highly politically charged – nowhere are the actual and interpretive battles as intense as at war's end. We have attempted to navigate this contested terrain by drawing on a wide range of sources, triangulating material and drawing on historical perspectives in order to achieve, to the extent possible, a balanced and evidence-based account.

Our theoretical standpoint builds upon previous SCAs, which were broadly shaped by a historically informed, political economy approach. In doing so we avoid a reified view of 'the ethnic conflict', instead analyzing the war as one manifestation of a deeper state crisis. This leads to a focus on; the changing nature of the Sri Lankan state within its global, regional and domestic setting; shifts in state-society relations over time; the role of inter and intra-elite competition in shaping political bargains, coalitions and settlements; the complex interactions between the economic and political landscapes including how specific economic policies reflect and reinforce particular constellations of power and forms of identity-based politics. Firstly this analysis helps us appreciate both the continuities and shifts in Sri Lanka's political economy – whilst the current administration appears in some respects to represent a sudden break with the past, an historical perspective also reveals profound continuities. This mirrors the nature of war to peace transitions more generally which always involve profound transformations, as well as continuities and legacies which continue to shape the peacetime political economy for years to come. Secondly, this perspective helps place international intervention in perspective. A political

economy analysis shows the primacy of domestic politics, the relative autonomy of domestic political elite decision-making and the limited channels of influence for international actors. Though this has varied over time according to shifts in governments and international policies, in general, externally promoted efforts to induce reforms or 'bring peace' in Sri Lanka have always had unintended and/or paradoxical effects. International engagement in the last peace negotiations are illustrative of this and stand as a warning of the dangers of external actors attempting to induce political change, when the legitimacy of, and domestic constituency for such changes are limited.

The report is divided into five sections: *Section One* examines the political landscape. At the political apex, it explains the circumstances in which the Rajapaksa government emerged into power in its first and second term, and the modes in which it draws legitimacy, exerts control, wields power, conceives of its role, and derives its agenda. It identifies three overlapping factors namely Sinhala nationalism, patronage and securitised development, which contributed to the sharp political ascendancy of the UPFA regime and the military eclipse of the LTTE. *Section Two* examines the economic landscape and policy agenda in post-war Sri Lanka at the beginning of the second Rajapaksa presidency. It provides an overview of the economic context and backdrop during the war and post-war periods, and goes on to describe the features of the country's emerging post-war economic policy agenda as well as key trends and nodes of linkage between economic policy-making, economic outcomes and the political sphere. *Section Three* examines the international and regional landscape, including the geopolitical context and the changed donor landscape. It focuses on the shift in Sri Lanka's external relations from west to east during the course of the Rajapaksa regime and its domestic political and economic implications. This shift has also created a very different operating environment for western donors, which is explored in detail. *Section Four* identifies key domestic drivers of change and describes the major factors and the axes of contention within and between the political and economic spheres that are likely to influence changes to the internal landscape over the next six years of the life of the present legislature and executive presidency. *Section Five* provides key conclusions and recommendations, focusing primarily on aid donors. The overall message for aid donors is that in this new environment they need to be aware of the limitations of external influence – whether from traditional western donors/power or from emerging powers. This SPA argues that the possibilities for a political settlement to the conflict to emerge are weak, and will be negotiated through the structural parameters of the government's ideological, political and economic imperatives.

## SECTION ONE - THE POLITICAL LANDSCAPE

### 1.1 Introduction: A Political Trinity

This section examines the core dynamics shaping Sri Lanka's contemporary political landscape. An exhaustive exploration is beyond the scope of this study and instead we have concentrated on those areas that are key to processes and dynamics of change. Consequently, we will focus on the overlapping dynamics of Sinhala nationalism, patron-clientelism and securitized development and their interrelationship with the contemporary GoSL policy agenda. It is argued that these dynamics have contributed to a hardening of the authoritarian and centralizing dynamics of the state, whilst on the surface paradoxically generating considerable legitimacy through the same vehicle of populist nationalism. These dynamics are manifestations of a broader crisis of both the state and society as institutions and spaces have become, in a circular manner, both the vehicles and effect of these dynamics. The current Rajapaksa regime thus bears considerable parallels with the UNP period of JR Jayawardene and Ranasinghe Premadasa, both of whom engaged in authoritarian and repressive practices combined with the fusion of Sinhala nationalism, populist welfare strategies and a growing integration into the global economy. In order to focus on how these processes shape the current landscape, we first turn our attention to nationalism, as this has been a resurgent dynamic over the last five years.

### 1.2 The Return of Sinhala Nationalism: 2000 to 2005

Since 2004 the UPFA administration has secured political legitimacy and electoral success through a combination of military victory and Sinhala nationalist mobilization. Sinhala nationalism can be understood as a socio-political representation of Sri Lanka, in which the territory, state and nation constitute a bounded unity revolving around a majoritarian axis of Sinhala Buddhist religion, language, culture and people (Rampton 2010a). This social representation consistently reproduces a hierarchy, placing the Sinhala nation at the apex with Sri Lanka's minority communities in a position of subordination (Kapferer 1988). These nationalist discourses have been circulating since the nineteenth century (Seneviratne 1999; Jayawardena 1972) but became hegemonic after 1956. Although there is a conception that nationalism is predominantly instrumental as it has been an electoral and legitimacy tool utilized by elites (Stokke 1998; DeVotta 2004), it is also clear that Sinhala nationalism has gradually assumed a hegemonic position in Sri Lanka (Brow 1996; Kapferer 1988; Rampton 2010a; Roberts 1994).

At the same time, nationalism has been subject to pendulum swings and between 1994 and 2003, both the Bandaranaike administration and the period of Wickremasinghe-Bandaranaike cohabitation there was a shift away from a more pronounced and consistent articulation of nationalist rhetoric as elites pursued, with external pressure, the possibilities of resolving the ethnic conflict through state reform in the direction of devolution (Rampton 2010b; Shastri 2004). Yet, far from signalling the demise of Sinhala nationalism, during the 1994 to 2004 period nationalist actors such as the JVP and the Sinhala Urumaya/JHU stepped in to fill the political vacuum and to take over the nationalist baton left by the mainstream parties (Rampton and Welikala 2005; Rampton 2010b; Venugopal 2010). These parties became politically ascendant in reaction to mainstream party platforms pledging to reform the state and/or to negotiate a peace with the LTTE. This was clearly apparent in relation to the period of both the PA Devolution Bill of 2000 and the 2001 to 2004 UNF-led peace process (DeVotta 2003; Goodhand and Klem, 2005; Rampton and Welikala 2005). Such dynamics, occurring against a backdrop of anti-Western and anti-Christian mobilization, can also be understood as reactions to the internationalization of the peace process, to post-tsunami humanitarian engagement in the island, to the emergence of the LTTE's quasi-state structures in the north and east, to the LTTE ISGA proposal and, finally, to the increasing elite, Colombo or Western Province-centric economic policy designed to integrate Sri Lanka more tightly into the globalised economic order. All of these dynamics were represented in nationalist discourse as pursuing a pro-LTTE bias, seeking the balkanization of Sri Lanka's unitary state and territorial integrity and the transgression or usurping of Sri Lanka's sovereignty.

Consequently, the nationalist mobilization spearheaded by the JVP and the JHU sought to revive a Sinhala nationalist project that appeared to have been dropped by the mainstream actors and to draw these elite actors back into the nationalist fold. In that sense, the process of Sinhala nationalist mobilization was given potency by the mainstream relinquishing of the nationalist baton and the apparent convergence of international and domestic actors' agendas during the 2002-5 period. This provided a surface against which the JVP and the JHU could accuse political elites of pro-Western inauthenticity in nationalist terms and a space wherein these peripheral actors could claim to be the true patriots and guardians of state sovereignty and national interest. As one JHU representative put it, "it was only under westernized elites, such as Chandrika and Ranil, that a Buddhist party could emerge and flourish."<sup>1</sup> The populist nationalist platform also mobilized a series of wider socio-economic and political discontents in the south around the various aspects of caste, class, regional, core-peripheral, urban-rural, vernacular-metropolitan and elite-subaltern divisions that have been described at length in the previous SCA (Rampton and Welikala 2005; Rampton 2010a; Rampton 2010b). It also drew figures from the PA onto nationalist platforms from the 2003 period and ultimately led to the forging of the UPFA coalition between the JVP and the PA and the significant contribution of the JVP's grassroots and nationalist mobilization to the coalition's 2004 electoral victory. This marked a first step in which popular discontents would be incrementally mobilized around and channelled into nationalist platforms between the 2005 to 2010 period.

### 1.3 Assuming the Nationalist Mantle: *Mahinda Chintana I* and the Return to War

Since 2005 the Rajapaksa-led UPFA government has in a series of political manoeuvres wrested the nationalist baton away from the subaltern parties and with it the mobilization of social discontents (Rampton 2010b). The first signs of this were the way that Rajapaksa managed to take control of the SLFP leadership and ran for presidential office in 2005. Although it is certainly the case that the PA had forged ties with nationalist actors such as the JVP, their influence on the manifesto pronouncements of the coalitions involved had been minimal, with the logic initially being the mutual benefits of combined electoral mobilization for both parties. However, in 2005 after the SLFP signed MOUs with both the JVP and the JHU, Rajapaksa's presidential manifesto, the *Mahinda Chintana I* was released; a document that was clearly influenced by nationalist motifs, understandings, developmental goals and representations of social and political space. The *Mahinda Chintana I* outlined a series of commitments related to virtuous citizenship, family values, strong social discipline as well as demanding the restoration of a strong Sri Lankan state, a reinvigoration of agriculture, irrigation and rural development (Rajapaksa 2005:43-48). The nationalist vision contained in the manifesto can partly be understood as a reaction to the legacy of the 2001-4 peace process and the post-tsunami landscape, with its stress on the recovery and preservation of unitary state sovereignty.<sup>2</sup> The manifesto commits itself to ridding the country of "external interferences" into solutions to the ethnic conflict and "foreign countries unnecessarily intervening into our internal affairs" (Rajapaksa 2005:30 & 34). It goes on to state that in the development of a "national consensus, the sovereignty of Sri Lanka, the territorial integrity, the unitary structure of the State... would be preserved" (Rajapaksa 2005:32). It is also notable that the document says relatively little about the political problems specific to the north and east, with a mere five pages dedicated to reconstruction, development and the establishment of a security net in the north and east with no mention of political issues and grievances. In essence the *Mahinda Chintana* represented an attempt to wrest back what is perceived as a loss of sovereignty and control over international and global currents that are represented as a threat to the nation and the unitary framework of the state, including specifically a commitment to reinvigorating the rural-focused settlement schemes of the past as well as a security-oriented strategy in the north and east.

The *Mahinda Chintana I* thus provided an early indicator of the direction of government policy in the 2005 to 2010 period. The preservation and protection of the unitary framework of the state, the commitment towards a tightened "security net" in the East and an emphasis on 'development' when dealing with problems in the north and east was incompatible with a peace process based on political negotiation with the LTTE; who also appeared to be intent on seeking self-determination and advancing this cause through a return to war rather than

<sup>1</sup> Author's interview, JHU representative, Colombo, December 2006.

<sup>2</sup> According to an interviewee, the term "unitary" was inserted into *Mahinda Chintana I* through JHU pressure and not without some resistance from Mahinda Rajapaksa (Interview, policy consultant, Colombo, September 2010).

negotiations.

#### 1.4 Nationalism, Militarization and Securitised Development

Therefore 2006/7 witnessed a return to war and the commencement of a military solution to the conflict in order to reassert sovereignty and preserve the unitary state framework. This option was facilitated by constraints placed upon the LTTE through the construction of the international security net,<sup>3</sup> the split in the LTTE itself, the escalation of LTTE attacks after December 2005, a utilization of the context and rhetoric of the 'Global War on Terror' and the willingness of regional and international states to offer military assistance, weaponry and technology (Smith 2010; Lewis 2010). The rapid defeat of the LTTE also owed much to the significant reorganisation of the military that took place, particularly under the custodianship of Chief of Army Staff, General Sarath Fonseka, which included the breaking up of battalions and the significant raising of salaries to military personnel (Pavey and Smith 2009:198-199). The 2004 to 2010 period witnessed a significant expansion of recruitment and raised expenditure on weaponry and military technology (IISS 2010:338; Pavey and Smith 2010:199; Tamil Guardian 2005).<sup>4</sup> Fonseka also used adept tactics in order to defeat the LTTE including playing the rebels at their own game through the deployment of a more fluid military strategy including guerrilla tactics and long-range penetration units (Pavey and Smith 2009:198-199). Interviews with former military personnel indicate that the intention was to fight a war for victory through any means necessary.<sup>5</sup> This strategy interpreted past stalemates and failures and future obstacles to victory as a result of a lack of ruthlessness when confronted with the challenge of preventing civilian casualties or of dealing with international and regional pressure and intervention.<sup>6</sup> The combination of the LTTE's readiness to use the Tamil civilian population as a human shield, the SLM's unleashing of massive firepower upon LTTE-held positions and the scant regard paid by either side to International Humanitarian Law and rules of engagement (particularly in the final three months of the war) led to large-scale civilian casualties (Lewis 2010; ICG 2010).<sup>7</sup>

The pursuit of the military solution has produced an intense militarization and securitisation of Sri Lankan social and political space, augmenting a past policy of using these apparatuses as large-scale public sector recruitment programmes (Richardson 2004; Venugopal, 2011a). There has also been a growing nexus between the military and Sinhala nationalist actors. Whilst, since the 1980s, the lower officer ranks and non-commissioned sectors of the military have been politically sympathetic to the JVP (Rampton and Welikala 2005:31-32), more recently a collection of political actors, including forces from the Patriotic National Movement, the JVP and the JHU, combined to produce bodies such as the *Manel Mal* or 'blue lotus' movement, a support and welfare body promoting the Sri Lankan military and assisting the families of military personnel (Rampton 2010b).<sup>8</sup> Between 2006 and 2009, militarization was apparent in daily life in the heavy securitisation in both the south and the north and east with checkpoints, bunkers and armed personnel being endemic throughout the country. The aim in the north and east was to occupy space with an armed guard 'under every tree', securing villages, road infrastructure and work improvements to the latter.

The pursuit of the military solution has also been accompanied by a campaign valorising the actions and

<sup>3</sup> This was imposed through the Ranil Wickremasinghe 2001-4 peace process. See Goodhand et al (2005).

<sup>4</sup> It should be noted that the gradual but significant recent expansion of the Sri Lankan military and security forces can also be traced back to the 2001 period when military hardware acquisitions were also doubled in many areas (Blodgett 2004; Tamil Guardian 2005).

<sup>5</sup> Interview with former military officer, Colombo, July 2010.

<sup>6</sup> *Ibid.*

<sup>7</sup> It should be noted that neither side throughout the course of the conflict has demonstrated much regard for rules of engagement and IHL. The Sri Lankan conflict has been called a 'no mercy war' because of the low proportion of survivors on the battlefield. Amnesty International for example estimated that 20,000 civilians died during the final months of the fighting, whilst ICG have stated, citing Gordon Weiss of the UN, that the figure may be as high as 40,000 (ICG 2010:5).

<sup>8</sup> The influence of the JVP in the military amongst the rank-and-file and junior officers has been a major factor in rumours of coup-dynamics. This no doubt impacted on the escalation of such rumours in relation to Sarath Fonseka's entry into politics and in the aftermath of his arrest, detention and trial (Interview, politician, Colombo, September 2010).

commitment of the troops in the war, depicting military victories, the Rajapaksa brothers and nationalist ministers like Champika Ranawaka fraternising with the armed forces. Such scenes, on advertising billboards, mobile telephone charge-cards and banknotes, form a vivid and potentially charged backdrop. The Rajapaksas and the UPFA have therefore gained political capital out of the militarization and the military victories that have been secured. The President is extremely popular in the south for having brought the war to an end: 'Rajapaksa is seen to have restored a sense of national dignity...there was a sense of having been humiliated by the LTTE, which explains the current triumphalism'.<sup>9</sup> Moreover, it has also facilitated the creation of a nationalist frontier which divides the world into a simplified binary of patriots (*deshapremi*) and traitors (*deshadrohi*) (see Rampton 2010a; Wickramasinghe 2009), a frontier which enables the containment and suppression of opposition and dissent so that alternative voices speaking to question the direction of government policy are automatically disqualified and rendered a threat to the nation. This in itself is not a new phenomenon, with '*bheeshanaya*' (state terror) being deployed by previous regimes to confront not only rebellions but also political dissent (Uyangoda and Bastian, 2008). But a new trend has been the elevation of the *ranaviru* (veteran soldier [*lit. golden hero*]) as a symbol of moral purity in the defence of the Sinhala nation, a term that may have begun to eclipse the similar status awarded to the smallholder farmer in nationalist discourse.

Militarization has also been a significant strand of the UPFA Government's development strategy in the north and east. As with many other 'post war' contexts, the north and east is treated as a blank slate, amenable to radical and irreversible political and economic reforms. The GoSL's strategy of 'securitized development' is driven by interlocking military, political and economic logics. First, the strategy has focused on the building of core infrastructure, particularly visible in the form of improved and new roads and bridges in the Eastern Province (Goodhand 2010). It aims to produce national and nationalist integration by ensuring that spaces which were once of blurred political-territorial control in the north and east are now permanently secured through a military and policing presence and an infrastructure that allows the swift deployment and response of security forces. Second, it may serve a dual political function of binding together diverse constituencies in the south, whilst splintering potential sources of opposition in the north and east. Development efforts, particularly large infrastructural projects, provide a ready source of patronage, necessary to bind together the disparate elements of the UPFA coalition and local proxies. Furthermore, this focus on development renders a political solution if not irrelevant then at least a secondary peripheral concern, a process that is already producing considerable unease amongst minority community representatives (see below). In the longer term there are concerns that development efforts will alter the demography (and electoral voting patterns) of the north and east, following in the footsteps of earlier colonization programmes. In spite of a common perception that demographic alterations in the north and east are taking place, there is limited evidence to date of systematic, state-backed Sinhalaisation (ICG 2008; ICG 2009).<sup>10</sup> More recent claims, centering on the north specifically, state that both development projects and militarization are accompanied by Sinhala colonization, as people are settled alongside new or redeveloped roads or the families of military personnel relocate to these areas. For example, in the wake of the defeat of the LTTE, it has been reported that houses for the families of what is a basically Sinhala military are being constructed on a significant scale in the north.<sup>11</sup> There are also increasing reports of involvement of military actors in official and/or unofficial business and rent-seeking activities.<sup>12</sup> Whatever the veracity of these claims, it is clear that development processes in the north and east have sparked insecurities about demographic change and access to political participation amongst the Muslim and Tamil minorities.

Third, the aim of securitized development is also to facilitate economic and socio-cultural transformation and therefore political transformation of so-called peripheral areas that have been subject to Tamil or Muslim homeland counter-claims. The ultimate goal appears to be one of opening up the east and the north to domestic and foreign investment, a process which is already taking place with respect to the securing of land for tourist

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<sup>9</sup> Sri Lankan analyst, Colombo, September, 2010.

<sup>10</sup> Also interviews, donor representatives, Colombo July 2010; Muslim and Tamil civil society and local government representatives, Eastern Province and Colombo, July 2010, September 2010.

<sup>11</sup> *Ibid.*

<sup>12</sup> Interviews, expatriate aid officials, Eastern Province September 2010.



development and other opportunities by Southern businessmen.<sup>13</sup> In much the same way that Ranil Wickremasinghe hoped that creating a ‘peace dividend’ in the east would blunt the secessionist impulse, the current government aims to resolve the ethnic conflict through economic development efforts, which will target the grievances that were assumed to have propelled the insurgency in the north and east. Although the ‘post-war’ situation has brought about some reduction in levels of militarization, particularly in the east – and to an extent, improved security – this does not signify an end to the ongoing logic of ‘securitised development’. Security forces still guard infrastructure and construction projects and maintain a significant presence in the north and east.

These three strands of securitized development – military, political and socio-economic – are nothing new in Sri Lanka, but they have been given new force. Whereas, the presence of the LTTE previously acted as a check on state-led dynamics of securitised development and nation-building, since their defeat, these barriers have been removed.

### 1.5 ‘Beacons and Smokescreens’: Sinhala Nationalism and the Government’s State ‘Reform’ Agenda

Alongside the pursuit securitized development, the GoSL has also followed a policy agenda geared towards mobilizing domestic and international support. Its trajectory can be conceptualized as a series of plotted beacons lighting up the policy path as each Sinhala nationalist goal and aspiration has been secured. However, these beacons have also been obscured by the construction of elaborate smokescreens seeking to capture or contain a range of potentially oppositional domestic and international forces.

The beacons that light up the nationalist path commence with the explicitly nationalist intentions pronounced in the manifesto agenda of the *Mahinda Chintana I*, central to which has been the reassertion of sovereignty and the unitary, centralised structure of the Sri Lankan state. Although it can be argued that *Mahinda Chintana I* was a manifesto pronouncement and that it was initially unclear which political direction Rajapaksa would take vis-à-vis the flagging peace process and on broader strategy, by December 2005 events ensured that the nationalist path and governmental strategy converged. It was in response to the LTTE’s incremental pursuit of coercive tactics after this date onwards,<sup>14</sup> that the GoSL pursued a ‘war for peace’, aiming to clear the Eastern Province of LTTE-controlled areas with the assistance of the Karuna faction.<sup>15</sup> The East thus became a crucial first platform to a war which would later be extended to the stronger LTTE bastions of the Vanni. Further beacons along the nationalist path include the expansion of Emergency Regulations in December 2006, which were designed to counter both the LTTE (despite the fact that the CFA still held when they were passed) as well as journalists and NGOs deemed to be working with, aiding and/or abetting LTTE goals and strategies or questioning the Government’s approach (Emergency Regulations 2006). A number of other landmarks denote the further extension of the centralised and unitary powers of the state.<sup>16</sup> This includes the challenge to the merger of the Northern and Eastern Provinces in 2006, the establishment and issuing of the report of the ‘Select Committee of Parliament for the Investigation of the Operations of Non-Governmental Organizations and their Impact’ (Parliamentary Select Committee 2008; Human Rights Watch 2007:97-99), the abrogation of the already defunct CFA and the passing of the Eighteenth Amendment to the 1978 Constitution, sweeping away the checks contained in the Seventeenth Amendment monitoring bodies and further reducing the power of the provincial

<sup>13</sup> Interviews, Muslim civil society representatives and expatriate aid worker, Eastern Province September 2010; Donor representatives, Colombo, July 2010. Economic integration of the south and the north and east has also been the specific aim of some USAID strategies such as CORE (Connecting Regional Economies).

<sup>14</sup> It is from this date, immediately after the November 2005 Presidential Election victory of Mahinda Rajapaksa, that the LTTE engaged in a series of ambushes, guerrilla strikes and intifada-like strategies against the Sri Lankan security forces.

<sup>15</sup> The justification for commencing this action was found in the Mavilaru incident in Mid-2006, in response to the LTTE shutting off of an irrigation sluice-gate which fed an area cultivated by Sinhala farmers in Trincomalee District.

<sup>16</sup> It should be noted that although political centralization has been pursued and reinforced in the past through political party and other interests, centralization as an effect has evidently interlocked with nationalism through the consequent lack of power-sharing and the bolstering of a state-centre that becomes the magnetic focus for nationalist mobilization and capture. See for instance the work of Tambiah (1992), Roberts (1994), Manor (1979) and Wilson (1988).

councils (Government of Sri Lanka 2010; Transparency International 2010).<sup>17</sup> During the same period, the public security ordinance (operative since the 1990s) was regularly invoked, requiring Tamils to register with local police stations and the eviction in 2007 of Tamils from lodge houses in Colombo, a move that brought considerable international and domestic criticism of the GoSL.

However, what might appear to be a clear vista on the unfolding of this path has been somewhat clouded by the projection of various government policy carrots or tactics. In relation to GoSL claims to be ameliorating the declining human rights situation during the war and to be seen to be addressing post-war ‘reconciliation’ now, both the *International Group of Eminent Persons* (IIGEP) and *Commission of Inquiry to Investigate and Inquire into Serious Violations of Human Rights* (Col) and, more recently, the *Lessons Learned and Reconciliation Commission* (LLRC) have been heavily criticized for either lack of independence, lack of clear boundaries from interference and obstruction, lack of protection for witnesses and failure to implement recommendations (Matthews, 2009; Foster 2009; ICG 2007a; Tamilnet 2010b).<sup>18</sup> On balance, it should be noted however, that the LLRC has produced some valuable testimony on disappearances and that the LLRC Chairman has stated that the body will not be limited by mandate. Consequently, it is not impossible that the LLRC will produce findings on abuses and violations that took place between 2001 and 2009. What is more difficult to gauge, however, is whether the lessons learned will lead to the implementation of safeguards to prevent future recurrence, as this has been the key problem with past commissions with similar areas of focus.<sup>19</sup>

This has been accompanied by the largely cosmetic pursuit of a political settlement that is still, on the surface at least, couched within vaguely consociational or power-sharing frameworks that demonstrated at least some continuity with the goals and strategies to reform the state that had been pursued between 1994 and 2004: what some scholars have referred to as an interregnum of ‘liberal peace’ interventions in Sri Lanka (Rampton 2010b; Venugopal 2009; Goodhand and Walton, 2009). Core to this approach was an understanding that the ethnic conflict was a crisis of the state and that the key to its resolution required a reassembly of an excessively centralized and unitary state framework which consistently reproduced Sinhala majoritarian political logic in the direction of a devolution of powers in order to provide ‘minorities’ with measures of power-sharing or limited autonomous rule. Key to this professed aim was the establishment of the presidentially convened All-Party Representative Committee on Constitutional Reform and Experts’ Panel (APRC) in July 2006, an entity which some commentators expressly described at the time as the manifest pursuit of the other ‘track’ to the military solution in so far as it would produce, through a politically deliberative process, a final set of recommendations for state reform (Gamage 2006). Without examining the history of this body in detail, it is clear that the APRC was, despite the genuine engagement of many of its expert participants and the production of a progressive ‘majority report’ and final document (APRC 2010), consistently sidelined and marginalized through presidential fiat and manoeuvring.

In the same way, after the liberation of the Eastern Province in July 2007, the GoSL made clear its aim to restore democracy to this region which had not witnessed provincial elections for 20 years and both local and provincial level elections took place in the province in 2008. These elections and the convening of the Provincial Council in 2008 were framed as a victory for democracy over terrorism and conflict and a crucial step towards post-conflict reconstruction. The President also pledged in 2008 through the APRC and through press releases, that the powers contained in the 13<sup>th</sup> Amendment and the Provincial Councils Bill would form a viable alternative to the proposals that had been proffered by the APRC process, so that the Eastern Provincial Council would become a testing ground for implementing already existing constitutional frameworks for devolution (Narapalasingam 2008).

Despite the fact that it had already been ruled by judicial authorities that the 13<sup>th</sup> Amendment did not undermine

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<sup>17</sup> The removal of the limitations on term were however, not popular with nationalist elements in the country including both the JHU and JVP. Interviews, local government politician, Colombo, September 2010.

<sup>18</sup> This Presidential Col was the tip of an iceberg of smaller commissions operating at the time and, indeed, of a mass of commissions historically which have for the most part been ineffective (ICG 2007; Amnesty International 2009).

<sup>19</sup> For instance, the rights abuses of the post-millennium period occurred in the aftermath of commissions looking into disappearances and abuses during the late 1980s and early 1990s including those that took place in relation to the second JVP insurgency.

the framework of the unitary state and that Parliament, the Presidential Executive and the representative of the centre at the local executive level, the Governor all held the balance of power over the Eastern Provincial Council, it is clear from the limitations imposed upon statute-making and the transfer of subjects (especially in relation to the areas of policing and land), that the political centre is in practice unwilling to devolve or allow autonomous power to the Provincial Council (CPA 2010a). This has been clearly articulated by the President in relation to police powers but is also apparent in the way that political and administrative apparatuses at the centre have monopolized development and reconstruction activities and have therefore undermined the role of the Eastern Provincial Council in such areas and therefore as a meaningful actor of local governance (CPA 2010a:39-42). The *Mahinda Chintana II* manifesto, whilst loosely discussing the need for a discussion about the 13<sup>th</sup> Amendment (*Mahinda Chintana II*, 2010:54), nonetheless still reiterates a pledge to “re-establish the Northern Provincial Council under the 13<sup>th</sup> amendment”, that “Provincial Council Elections will be held in the Northern Province within a short period of time to establish democracy”, that the President “will seek the assistance of the Provincial Councillors of the Northern Province to expedite and strengthen the Uthuru Wasanthaya development programme”, that it is recognised that “the 13<sup>th</sup> Amendment is an intrinsic part of the constitution through the 13<sup>th</sup> amendment and is a functional system”, and finally, that, through this, “new representatives will be included in the All Party Conference and... that this would be a forum to arrive at a true national concurrence” (*Mahinda Chintana II* 2010:52-55). In this way, the Northern Provincial Council is again used as a vehicle to create an appearance of democratization and empowerment in the north, even though the Eastern Provincial Council has proven to be powerless in its ability to pass statutes or to engage in development in a meaningful sense.

Rajapaksa’s manifesto pledge for the 2010 Presidential Elections reiterates the same promises for the Northern Provincial Council as had been first made with respect to the Eastern Province, thus suggesting that this strategy was a time-buying and politically expedient exercise for a regime, eager at one time, to keep its TMVP allies in the Eastern Province onside and deflect the anxieties of international actors, including India, as to the prospects for even an interim political solution. However, this strategy may have outlived its shelf-life as the prospects recede of the provincial councils or the 13<sup>th</sup> Amendment offering a serious channel for a political settlement and/or devolution, although this channel continues to be a platform for potential negotiation by some TNA representatives.<sup>20</sup>

Although it cannot be ruled out, given the above analysis, an inclusive political settlement is unlikely to be forthcoming. In fact the current regime appears to be operating in the belief that the solution has for the most part already arrived through military victory and will be concluded through the securitized development strategy outlined above. Such an analysis is borne out by the current political context in which there is an absence of pressures that would make a more inclusive political settlement an attractive option for the UPFA regime. Firstly, the political presence of the LTTE was arguably the most significant pressure that brought successive governments either to the negotiating table or to the drafting of frameworks for state reform. After the defeat of the LTTE and the weakening of, and splits in the TNA (see below), this internal pressure has for at least the short-to-mid-term been removed. Secondly, external pressures for state reform from India and state actors, is limited as explored further in Section Three. Finally, it is also clear that through a series of local and national elections between 2008 and 2010, on the back of consistent military victories, and through adept manoeuvres in patronage politics, the President and the UPFA regime have managed to consolidate power to the extent that they, to all intents and purposes, control the two-thirds majority in parliament necessary to enact constitutional change.

The constitutional change that has taken place, namely the 18<sup>th</sup> Amendment, manifests a logic thoroughly immersed in both nationalism and further centralization of state structures.<sup>21</sup> The 18<sup>th</sup> Amendment is partly geared towards the consolidation of Rajapaksa’s control over dynastic power through the extension of term. However, it goes beyond this by vesting the power of appointment to 17<sup>th</sup> Amendment monitoring bodies in the President and by removing the powers of provincial councils to make statutes with respect to provincial subjects and the need for the assent of provincial councils to be sought when legislating on provincial subjects

<sup>20</sup> Interviews, constitutional expert, civil society representative, provincial councillor and member of parliament, Colombo July 2010 and Eastern Province, September 2010.

<sup>21</sup> For the nexus between nationalism and centralization, see footnote 17 above.

(Transparency International 2010; CPA 2010b). So although dynastic power is not insignificant when analyzing the 18<sup>th</sup> Amendment, its provisions indicate the intent of the Rajapaksa administration to further centralize the structure of the State and to buttress the already wide powers accruing to the President.

### 1.6 Patronage Politics and a New Social Assemblage: the Consolidation of the Rajapaksa Dynasty

It has long been noted that Sri Lankan political culture, like other South Asian societies, has manifested a powerful degree of patron-clientelist politics with a tendency for political parties and elites to be assembled under the dominant custodianship of dynastic families which for the most part have been drawn from the anglicized colonial and postcolonial ruling classes, classic examples being the Bandaranaiques and Senanayakes in relation to both the SLFP and UNP respectively. Patron-clientelist politics may have been dominated by these ruling families but it nonetheless has spread its tendrils across society so that access to resources, from development infrastructure to access to employment (particularly in the public sector) and the awarding of business contracts has, to differing degrees of intensity from one moment to another, been governed by personalized, kinship, caste or family-based ties (Hoglund and Piyarathne 2009; Jayantha 1992; Rampton 2010a; Roberts 1994; Stokke 1998). These tendrils act as vertical chains that link subordinate clients to the gatekeepers to the extent that politicians seek portfolio as the ultimate resource to grease the patronage machinery which links patrons to clients.

The Rajapaksa administration has intensified a longstanding tendency for patron-clientelism but there are also some signs of a potential shift in the class composition of the political elite.<sup>22</sup> There has been a longstanding cleavage in Sri Lankan society manifest in tensions between the traditional anglicized ruling classes on the one hand and, on the other a range of rising intermediate, vernacular-oriented, rural and suburban social groups (Rampton 2010a),<sup>23</sup> which might loosely be termed subordinate and intermediate classes. It is on this axis that the Rajapaksa regime has introduced a potential shift with the President himself coming from a well-established political family, but from a particular branch of the family which did not seek earlier social acculturation into the anglicised ruling elites and which also emerged from the lower rungs of the Goyigama caste grouping.<sup>24</sup> As a result there appears to have been a broadening and deepening of the Sinhala social strata represented in parliament, giving greater potency and prominence to the nationalist values articulated by the current. These forces can be discerned in the UPFA, in allies such as the JVP off-shoot, the *Jathika Nidahas Peramuna* and in the *Jathika Hela Urumaya* which represents the new and aspiring professional and middle classes at the upper end of this subaltern class bloc. Rajapaksa has also pursued a development strategy, which, on the surface, goes beyond the historical dominance of elite-led Western-Province-and-Colombo-centric development patterns with infrastructural improvements that are expressly targeted on rural and peripheral areas. Although

The ascent to power of the Rajapaksas represents a partial challenge to the traditional social representation in the ruling elites, as well as signifying the emergence of a new dynasty. The immediate family control the inner hub of the regime in the form of the President, Mahinda Rajapaksa and the two younger brothers, the Defence Secretary, Gotabaya Rajapaksa and the Minister for Economic Development, Basil Rajapaksa. Mahinda's son, Namal, was standing in the wings but increasingly seeks to take centre-stage as heir apparent and as an MP with increasing involvement in development and business activities in the rehabilitation and reconstruction of the north.<sup>25</sup> Mahinda's older brother, Chamal is an MP and the Parliamentary Speaker whilst Nirapuma Rajapaksa, Mahinda's cousin is a deputy minister. A number of nephews and other cousins have also been granted posts in the diplomatic service or at local government level (Ramachandran 2010).

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<sup>22</sup> N.B. that we qualify this as a 'potential shift' as it is too early to tell whether these dynamics are a long-term challenge or confrontation with the dominance of the 'traditional' anglicized ruling classes or a moment of significant upward social mobility that may yet reproduce the same indicators of class distinction that have hitherto dominated.

<sup>23</sup> Also cf. interview, local NGO representative, July 2010.

<sup>24</sup> Cf. interview provincial councilor, Colombo, July 2010.

<sup>25</sup> E.g. see <http://www.namalrajapaksa.com>

The inner hub of this patronage network controls much of the policy frameworks and development ventures pursued by the current regime and evidently overlaps with the current strategy of securitized development in so far as the Ministry of Defence, the Ministry of Economic Development and the Presidential Task Force have been the key government apparatuses through which development programming must be filtered for approval and which frequently also act as the designated partner agencies for development activities, particularly in the reconstruction of the 'post-conflict' areas of the north and east.<sup>26</sup> Large scale development programmes are a potential source of rent-seeking, corruption and kickbacks.<sup>27</sup> According to many sources, there is an intensified culture of corruption at different levels of the state and in society more widely – including the top-rungs of Government, the bureaucracy, local government, business, security personnel and some NGOs.<sup>28</sup>

However, patronage is not just a vehicle for dynasty-building and economic and development activities. It has also provided the means to crush or appropriate political opposition into a government that now effectively commands a two-thirds majority in parliament and whose representatives are drawn from dissenting sections of almost every political entity (including the LTTE) and from diverse social and ethnic backgrounds. The UPFA administration has thereby shifted from a government with a narrow parliamentary majority in the 2004 to 2010 period to a commanding position over the legislature that is unparalleled since the UNP regime of JR Jayawardena. That this has occurred in the context of a proportional electoral system that usually produces weak coalitions is even more striking. In order to achieve this 'rainbow coalition' and the consolidation of power, alternate centres of power that could rival the Rajapaksas' control of the patronage-security-nationalism trinity have been countered and silenced through an admixture of post-war electoral consolidation, coercion and fear instilled through the nationalist bifurcation of the political world into stark binary opposites of 'friend' and 'enemy'. This was clearly apparent in the battle over the presidential election in which Sarath Fonseka, as the victorious general who had defeated the LTTE, sought to wrestle the mantle of nationalist authenticity from the Rajapaksas through an alternate centre of power based on the military and the political opposition including particularly the JVP. Fonseka therefore had his own potential networks of power tied into the security apparatuses and represented a rival to the Rajapaksas' nationalist credentials and post-victory triumphalism. His defeat therefore required skilful manoeuvring from the Rajapaksas which included marginalizing Fonseka and his military networks long before the presidential election took place (Jeyaraj 2009b, 2010a, 2010b), and then using coercion and repression to neutralize his capacity to mount adequate opposition during and after the Presidential Election. This also operated on a discursive and not just institutional terrain as Fonseka's accusations of war crimes against other members of the military in relation to 'white flag' incidents at the end of the war was utilised as evidence of his betrayal of the national cause in the service of foreign interests.

Rajapaksa has also skilfully utilised the political culture of patronage as a means of dividing political opposition and luring dissatisfied elements of opposing political forces into the UPFA camp either through the promise of the spoils of office or allegedly through threat of one form or another. This has occurred to the UNP in successive waves over the last 5 years, to the JVP in 2008 and UPF in 2010. Although the SLMC remained in opposition between 2001 and 2010 (apart from a brief crossover between January and December 2007), and in electoral coalitions with the UNP, the party itself has suffered successive crossovers to the UPFA which culminated in 2010 with the party supporting the 18<sup>th</sup> Amendment and officially joining the GoSL in November 2010. The Rajapaksa regime has also used similar tactics to absorb and weaken potential regional centres of power so that the TMVP split in 2008 between the Karuna and Pillaiyan factions and saw the former fully absorbed into the UPFA machine whilst the TMVP was left presiding over a weak and ineffective Eastern Provincial Council and without any gains in the last parliamentary election. Similar tactics have been deployed in the north and amongst diaspora networks, with the UPFA regime using proxies such as the EPDP with limited success and, according to reports which need further corroboration, the ex-LTTE leader, 'KP' Selvarasa Kumar Pathmanathan allegedly in relation to intelligence gathering, development, rehabilitation and reconstruction activities focused on both the

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<sup>26</sup> Interviews, donor and aid agency officials, Colombo, July 2010.

<sup>27</sup> Interviews, civil society representatives, aid agency officials, Colombo, Eastern Province and Northern Province, July, September and October 2010.

<sup>28</sup> Interviews, journalist, civil society representatives, aid agency officials, Colombo, Eastern Province and Northern Province, July, September and October 2010.

Diaspora and the north (Silva 2010), a process that has been ironically described as “Sri Lanka-style reconciliation”.<sup>29</sup>

The Rajapaksa administration has consolidated and expanded its power by bringing together a broad coalition of forces through the utilization of patronage, which makes it necessary for political leaders to obtain portfolio in order to access development resources to distribute to clients. The breadth and scope of what can be described as a ‘rainbow coalition’ is drawn from every ethnic and regional identity and area and has continued expanding even after the elections of early 2010. However, whilst this demonstrates the capacity for centripetal cohesion through patronage, clientelist systems are also constantly vulnerable to tensions, which can, particularly in relation to seismic political triggers, lead to a rapid and destructive centrifugal unravelling and realignment. These tensions may already be present in the current political coalition as it has been rumoured that sections of the UPFA are discontented with the closed, family-knit character of the regime which has a tendency to monopolize and centralize possession, control and disbursement of the loaves and fishes of office and of rent-seeking activities. There are also persistent rumours of serious tensions between elements of the inner hub including discontent between Basil Rajapaksa and the Mahinda-Namal Rajapaksa lineage as to the future direction of the dynasty and the divisions of power within it, especially with regard to conflicts between Namal and Basil over control of processes of reconstruction in the north (Ramachandran 2010; Sunday Leader 2010). Such discontents both within the dynasty and beyond will probably have worsened with the recent passage of the 18<sup>th</sup> Amendment to the Constitution which has been read both as extremely authoritarian in intent and designed to secure the dynastic lineage for the future through the removal of limits on presidential term.<sup>30</sup> However, in the short term there seems little likelihood that such tensions will produce serious threats to the political stability of the GoSL, unless a major economic and/or political crisis creates an opening for a realignment of forces. It is also clear that the GoSL’s capacity for suppressing dissent has managed to curtail political threats in the short term.

However, these short-term tactics may themselves produce political discontents and resistance in the long term. Although the current context is very different, the historical lesson of the 1980s, when the authoritarianism of the JR Jayawardene and Premadasa administrations contributed to widespread conflict and to the context for the overthrow of 17 years of UNP rule, bears some comparison. The Rajapaksa-led administration also follows a familiar pattern of government-opposition antagonism, in which the winning parties make use of their majorities to bring about fundamental changes to state policies and abuse power in a partisan way (Uyangoda and Bastian, 2008). Such moments of change have led to a blurring of the distinction between state and regime. It is hardly inconceivable therefore, that opposition will regroup and fragmentary fissures will appear in the ‘rainbow coalition’ itself, especially at subsequent elections. To some extent, the UNP is in disarray because of internal divisions and it is highly likely that the party will experience a renaissance if these problems are resolved, with commentators pointing to a change of leadership and even to Sajith Premadasa as the key to this possible outcome.

### 1.7 Political Opposition, Civil Society and Diaspora Forces

As already mentioned the Rajapaksa regime has consolidated power politically through successive and decisive electoral victories between 2008 and 2010 and a divide and rule strategy operative within the framework of patronage politics. The suppression and containment of opposition has also been achieved through the pursuit of the military defeat of the LTTE and the overlapping strategies of nationalism and securitized development. As already noted, nationalist rhetoric has created a widely supported populist division between friend and enemy and between patriotic and unpatriotic forces. The securitized development strategy also tends to insulate the GoSL from the political pressures that would result from a politically negotiated solution or a genuine open discussion of state reform. The pursuit of such changes by past regimes has been undermined by ‘ethnic

<sup>29</sup> Cf. interview, donor official, Colombo, 2010.

<sup>30</sup> Elements within the core UPFA, principally made up of the Left parties within the coalition, initially threatened to block the passage of the Amendment. See Fernando (2010).

outbidding’ with parties in opposition torpedoing government efforts at ethnic accommodation (DeVotta 2004; Bush 2003; Manor 1989).

This combination of Government consolidation, securitized development, and populist legitimacy in the south has effectively quashed the capacity of political parties to criticize or question the Government. Illustrative of this has been the Government’s arrest and trial under court martial jurisdiction of potential threats such as Sarath Fonseka, increasing violence used in electoral campaigns and against mobilization by grass-roots parties such as the JVP (e.g. Tamilnet 2010c), the assassination of vocal media figures such as Lasantha Wickrematunga, in the detention of journalists under emergency regulations (e.g. Tissanaiyagam), in attacks on and death threats against civil society actors and NGOs and in the atmosphere created by a general deterioration in the human rights context amidst such activities and widespread abductions and killings between 2005 and 2009 (ICG 2007; Human Rights Watch 2008).

Although, the scale of these human rights abuses has declined in the post-conflict environment, it has not diminished an understandable fear on the part of political and civil society actors and reluctance and self-censorship in relation to vocalizing opposition to the present Government policy agenda. The space for political debate is much diminished.<sup>31</sup> For instance, federalism has become a “dirty word” (Rajapaksa cited in Vellor 2010), ‘devolution’ is also rapidly taking on the same negative associations and this is clearly manifest in the willingness of political opposition parties to claim a shift in their position on a political solution, to the extent that the UNP (which has been reduced to 43 opposition bench members through electoral losses and crossovers), has itself stated that there is no longer an urgent need to pursue a political solution but to instead work towards the normalization of the north and east (BBC 2010). Additionally, the UNP is increasingly beset by internal feuds, mainly over Ranil Wickremasinghe’s refusal to stand down as leader despite the recent history of recurrent electoral defeats and support for Sajith Premadasa as a politician who has a constituency amongst the rank-and-file and who will be more capable of contesting the UPFA for the populist-nationalist mantle, given his ideological orientation and his family background and status.<sup>32</sup> Likewise, the JVP has suffered a reversal of electoral fortunes with only 7 DNA representatives attaining seats in the 2010 General Election, a level below the 16 seats they attained in 2001 before they entered coalition with the UPFA in 2004. Yet, the JVP are far from a spent force and still retain a strong constituency amongst university students, the military and will provide a constituency base for those political elements disaffected with and marginalized by the current government. As a core constituent of the DNA they also continue to mobilise the supporters of Sarath Fonseka whose detention and trial still rankles amongst detractors of the Rajapaksa-led government. They will therefore remain key to future dynamics of opposition.

Likewise, whilst the TNA, through a nonetheless diminished 14 electoral returns in 2010 (in a context where the TMVP returned no parliamentary seats), has managed to demonstrate that there is still support in areas of the north and east for its moderated demand for Tamil-speaking autonomy which has also included a profound distancing from the Diaspora influence,<sup>33</sup> the party has also suffered internal divisions and the departure of more pro-Government as well as defiantly pro-LTTE sections before the elections. The party is also caught between a rock and a hard place in so far as its willingness to negotiate with the GoSL will impair its legitimacy if no political solution is forthcoming. The SLMC with 8 seats in parliament, despite fairly consistent opposition to the Rajapaksa regime since 2004 and criticism about the political situation in the East and the failure to deal with the national question, supported the passage of the 18<sup>th</sup> Amendment Bill rather than risk a further fracturing of the party<sup>34</sup> and in November 2010 crossed over officially to the Government benches, securing Rauf Hakeem’s ministerial portfolio. This strategy will protect the party in the short term by preventing further factions from emerging and ensuring access to development resources. However, despite understanding this short-term logic, local SLMC supporters in the East have expressed considerable ambivalence about the longer-term effects of joining the GoSL. They fear that this will not assist in the resolution of longer-term questions such as land issues

<sup>31</sup> Interview, Academic, Colombo, July 2010.

<sup>32</sup> Interview, Sri Lankan MP, Colombo, July 2010.

<sup>33</sup> Interview, Sri Lankan MP, Colombo, July 2010.

<sup>34</sup> Bashir Segu Dawood and up to 5 other SLMC MPs were already threatening to cross over to the Government at the time of the 18<sup>th</sup> Amendment vote. .

and the empowerment of local government structures, which they feel are being wilfully neglected by the current administration.<sup>35</sup>

The SLMC are also in a difficult situation, in so far as their party has been progressively weakened in poll showings and through crossovers and splits since the 1990s. Ironically, the weaknesses have also been exacerbated through the defeat of the LTTE. This works in two ways. On the one hand it has removed a key antagonist that facilitated the emergence and mobilization around the SLMC in the first place. Paradoxically, however, and as noted at the outset of this section, this has also removed barriers and checks upon the expansion of southern interests and Sinhala nationalist domination, including around fears of colonization, land ownership and business competition, which is why a number of Muslim voices in the Eastern Province have also expressed mixed feelings about the defeat of the LTTE.<sup>36</sup> Yet, Muslim political leadership has therefore also felt that the only way to secure development concessions and to achieve a minimal level of security in this context is through cooperation rather than staying with a progressively weakened opposition. Thus we have seen the rapid eclipse of the kind of more strident political articulation of Muslim interests that underpinned the ‘Oluvil Declaration’ of 2003 and assertions of the need for power-sharing frameworks for Muslim homelands. However, the downside to this subordination to the current government is that it may also breed younger generations attuned to a more radical political path, which will in the long term undermine the party.<sup>37</sup>

Consequently, the political opposition as a whole is in disarray and this weakening of democratic dissent was more than in evidence during the 18<sup>th</sup> Amendment Bill when elements of the UNP supported the legislation, the SLMC as a whole voted with the Government, the grass-roots JVP only managed to muster a few thousand protesters in street protests and rumours of potential TNA support for the Bill were also reported.

In the same way that political forces have either swung in support of the Rajapaksa regime or have had their own willingness or capacity to mobilize opposition curtailed, civil society opposition has itself dwindled with NGO actors struggling to continue pressuring the Government for a political solution in a context of increasing control, harassment and interference by government agencies. This tendency has been exacerbated by rumours and allegations of financial irregularities with some local NGOs.<sup>38</sup> Some of these civil society actors also feel that they have effectively been abandoned by the ‘traditional’ donors as many of the Western and/or Northern states reduce their expenditure on partnerships and software programming in Sri Lanka and/or seek to normalize their relationship with Sri Lanka and to fit in with the emergent development framework.<sup>39</sup> These fears are compounded by concerns for their future in a context where China and India are increasingly resorting to forms of direct development or partnership with the state.<sup>40</sup>

Although elements of the business community backed the Wickremasinghe peace bid, in the current context the business sector, including previously dedicated pro-UNP elements, has increasingly courted the patronage of the Government.<sup>41</sup> In the 2001 to 2004 period, the business elite were riding on the prospects of a peace dividend and long-term stability through a negotiated settlement and/or development for peace but have gradually switched since 2005 to backing the current war for development. Again the picture is not so much one of the classic western-derived model of oppositional dynamics between a resistant civil society and a predatory state but more the manner in which, as in other South Asian contexts, the state and civil society are profoundly inter-

<sup>35</sup> Interviews, provincial councilor, pradeshiya sabha member, SLMC supporters, Eastern Province, September 2010.

<sup>36</sup> Interviews, local government and civil society representatives, Eastern Province, September 2010.

<sup>37</sup> It has long been rumoured that the Eastern Province has experienced the growth of radical Muslim groups, including armed factions. Little evidence has been gathered however that this is in any way significant at present. However, there are intra-group tensions within the Muslim community producing clashes between ultra-orthodox Salafi Tawhid, Sufi and other traditions. For instance, the Eastern Province has witnessed clashes of this kind in 2004 and 2006 (ICG 2007b). In separate incidents in 2008 and 2009, clashes took place between rival Muslim groups in Gampaha and Beruwela in the South. It is more likely that these are discrete, localised and sporadic incidents rather than a long-term concerted trend towards radicalisation (ICG 2007b).

<sup>38</sup> Interviews, local NGO representative, journalist, provincial councilor, donor officials, Colombo, July 2010.

<sup>39</sup> Interview, local NGO representative, Colombo, July 2010.

<sup>40</sup> *Ibid.*

<sup>41</sup> Interviews, businessman, local NGO representative, Colombo, July 2010.



penetrating rather than oppositional spaces (Kaviraj and Khilnani 2001; Chatterjee 1994). Whilst this inter-penetration is never absolute and there are always constituencies and elements that escape or counter state power, it is clear that even such constituencies as the universities, youth and the intellectual strata who may be resistant to the current political project are themselves frequently unable to transcend or counter the hitherto dominant frameworks and discourses of nationalism that the current Government have so successfully navigated (Rampton 2010a).<sup>42</sup>

However, the fieldwork in the Eastern and Northern provinces revealed that many of the long-term divisions and discontents that fuelled the war are not being dealt with. Interviews with the Tamil community and civil society representatives, local government officials and aid agency staff revealed that in spite of a modicum of economic recovery, there is also profound and collective depression and anger in relation to the issue of war crimes, the nature of the defeat of the LTTE, the tragic human loss in the final year of the war, the repression and control utilized in the securitized encampment and containment of the displaced, the apparent lack of political will on the part of the President to pursue a political solution, or for the south as a whole to acknowledge Tamil grievances.<sup>43</sup> As one respondent in Batticaloa stated, 'it is not possible to talk about reconciliation now, we feel more humiliated and 'minoritized' than ever'.<sup>44</sup>

Indeed, this palpable anger is directed at the Sri Lankan state, at the lack of remorse or sympathy exhibited by the south and against Western international donors and India for what is seen as their complicity in the nature of the end of the war (including military assistance), the failure to intervene or put significant pressure on the Sri Lankan Government over rights abuses, war crimes and the scale of the killings in Mullaitivu in the final months of the war and the failure to take Tamil grievances and the Tamil homelands claim seriously.

In addition to this, both Muslim and Tamil interlocutors lamented the ongoing failure to address long-standing and fundamental issues and points of conflict which impact upon the north and east including ongoing irregularities and disputes over land ownership and distribution, access to land, the increasing Sinhalisation of areas of the East and now the north and the monopolization of post-conflict development opportunities by Sinhala and southern-based business, banking and political interests.<sup>45</sup> There is also considerable anger and disillusionment amongst both Muslims and Tamils about the failure on the part of the GoSL to implement any kind of power-sharing or devolution, with the refusal to transfer powers to the Eastern Provincial Council and the recent 18<sup>th</sup> Amendment interpreted as a manifestation of the genuine long-term intent of the President.<sup>46</sup>

This has produced some surprising responses in the Eastern Province fieldwork from both Muslim and Tamil interlocutors who have lamented the passing of the LTTE for the political vacuum it has created in terms of providing a robust voice for Tamil demands and a check on Sinhalisation and Sinhala-dominated state power.<sup>47</sup> This has created a situation in which both Tamils and Muslims are increasingly concerned about their standing vis-à-vis the Sri Lankan state and their subordinated and marginal position in relation to citizenship frameworks in the island.<sup>48</sup> All of these concerns are also manifest in the continuing exodus of Tamils from Sri Lanka over one year after the conflict ended, a trend that has prompted a recent 'moral panic' about immigration in Canada (Jones 2010).

Finally, the political landscape also needs to be understood in relation to the Tamil Diaspora which has long been an engine, amongst others, of Tamil nationalist mobilisation.<sup>49</sup> Between July 2007 to early 2010, there appeared to be an increase in the scope and intensity of Tamil Diaspora mobilisation, largely as a result of developments in

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<sup>42</sup> Interview, academic, Colombo, September 2010.

<sup>43</sup> Interviews, civil society representatives, aid agency official, Colombo, Eastern Province and Northern Province, September and October 2010.

<sup>44</sup> Interview, civil society leader, Batticaloa September, 2010.

<sup>45</sup> *Ibid.*

<sup>46</sup> *Ibid.*

<sup>47</sup> Interviews, civil society representatives, aid agency official, Colombo, Eastern Province, September 2010.

<sup>48</sup> Interviews, civil society representatives, Eastern Province, September 2010.

<sup>49</sup> Several Diaspora based-Tamils were early members of the Tamil militant groups, including the LTTE's Anton Balasingham.

the closing stages of the war including reports of mass casualties in eastern Vanni between January and May 2009. Although, the public prominence of these protests, marches and meetings tailed off through much of 2010, 'Heroes Day' commemorations in November 2010 included 50,000 people filling the Excel Centre in London's Docklands, an event appears to counter the narratives of a complete breakdown in the Diaspora Tamil nationalist movement (e.g. Jeyaraj 2009a; 2010c, 2010d).<sup>50</sup>

In early 2010, a number of referenda amongst Western Diaspora centres drew widespread community participation, which produced support for Tamil Eelam, but whether these can be judged as a reliable litmus test of Diaspora opinion is open to question. To some extent the peace negotiations opened up new spaces within the Tamil Diaspora, leading to a greater divergence of opinions and groupings. The war for peace appears to have generated a mixture of trends, which have unsurprisingly been interpreted in different ways. On the one hand it has been claimed that the Tamil nationalist movement as a whole is in serious disarray and riven with factionalism in the wake of the demise of the LTTE and its funding and organizational networks (Jeyaraj 2009a, 2010c, 2010d). This perspective emphasizes the disconnect between the international Diaspora and Tamil politics and aspirations within Sri Lanka (ICG 2010a: i). On the other hand, some argue that diverse Diasporic groups broadly operate within an architecture supportive of the aims and aspirations of Tamil nationalism (Vimalarajah and Cheran 2010).<sup>51</sup> However, it has also been argued that this consensual, hegemonic framework is "artificial" and requires greater acceptance of differences between diverse factions (ibid).

Two of the more prominent Diaspora institutions today are the US-based Transnational Government of Tamil Eelam (TGTE) and the Global Tamil Forum (GTF). The former, which emerged initially from the activities of 'KP' Pathmanathan, has since his arrest distanced itself from him and is led by Visvanathan Rudrakumaran. The TGTE has since held elections in all major Diaspora centres and set up a 'parliament' of some 200 individuals, which has met twice in the United States to form a constitution. Whilst it is not clear what the TGTE's longer-term strategy and action program are, what is notable is its search for popular acceptance through elections and attendant campaigning by several hundred aspirant individuals.

The GTF, formed in mid-2009, is a coalition comprising several already existing Diaspora organisations.<sup>52</sup> For example, the UK actor in the GTF is the British Tamil Forum (BTF), which was formed in early 2007.<sup>53</sup> Meanwhile, elements of the LTTE abroad continue to exist. This has led to persistent discussion of different individuals being 'leaders' of the LTTE. For over a year this has been rumoured to be an individual with the nom-de-guerre 'Nediyavan', though recently another individual, 'Vinayagam', has been suggested (Jeyaraj 2010c, 2010d).<sup>54</sup> Whatever the truth about leadership, some commentators have ruled out the possibility in the post-2009 period of an LTTE resurgence, arguing that the existing remnants of the LTTE are fractured and lack legitimacy (Jeyaraj, 2010c, 2010d).

However, some of the leading actors in the Tamil Diaspora are far from abandoning or moderating their stance on the Tamil nationalist question (see also ICG 2010a). The events of the final months of the war constituted a key historical landmark in Tamil nationalist memory and were a catalyst for renewed mobilization. Some argue that the Tamil nationalist agenda is very much in place, leaving open the possibility for the re-emergence of a hegemon that can unite the fissures and lead the struggle. All major Diaspora actors continue to place

<sup>50</sup> In 2009 DBS Jeyaraj wrote a piece equating the lack of public commemoration for LTTE leadership with the demise of Tamil nationalism and the divisions in the Diaspora (Jeyaraj 2009a).

<sup>51</sup> This study is the result of a UK government funded project begun in 2008 through the Berghof Foundation.

<sup>52</sup> Rhizome-like structures refer to mobilization that is horizontal and counter-hierarchical. In other words it has no obvious hegemon.

<sup>53</sup> The BTF is itself a coalition of eighty UK-based Tamil political, cultural, religious and social organisations.

<sup>54</sup> The significance for Diaspora mobilisation of Nediyavan who has not been declared as leader by the LTTE, or ever taken a public role, has been challenged by other sources. These suggest that the idea of a imminently resurgent LTTE led by Nediyavan (who is said to live in Norway) is promoted in order to legitimate continuing securitization and emergency regulations in Sri Lanka, drawing on latent suspicion of Norway and the West (Rudrakumaran is based in Washington), and to demonise Diaspora actors – other than KP's supporters – as LTTE fronts. This is not, the sources add, to deny the LTTE is not active, but that it is not openly operative within the new pan-Diaspora Eelam front. Cf. interview, Tamil Diaspora member, 2010.

engagement with the international community, including their host states, at the centre of their strategies. These include links with governments, but also political parties and mainstream Western advocacy networks.

Western establishments have in some cases engaged directly with, these groups. The GTF's formal launch, for example, took place in February 2010 in the UK Houses of Parliament and drew clear endorsement by figures such as Prime Minister Gordon Brown, Foreign Minister David Miliband, Opposition leader David Cameron, shadow Foreign Secretary William Hague, as well as US Assistant Secretary of State, Robert Blake.<sup>55</sup> Many commentators point to an ideological and discursive 'disconnect' between the Tamil Diaspora and the home community (ICG 2010a: i). Whilst this gap undoubtedly exists, its magnitude may often be exaggerated for political purposes. Transnational political linkages are not unusual or aberrant in the contemporary world (Al Ali et al 2001; Lyons and Mandaville forthcoming) and the continued flight of thousands of Tamils from Sri Lanka suggests that connections are ongoing and widespread.<sup>56</sup> The endurance and articulation of Diaspora grievances is central to an assessment of the likelihood of a return to armed conflict to Sri Lanka. Also important is the extent to which the pursuit of authoritarian strategies of governance and securitisation are sustainable. After all, the 1980s insurrection of the JVP emerged at the intersection of the nationalist dynamic of the Indo-Lanka Accord and a long period of severe political repression of radical forces by the Sri Lankan state. Finally, there is also the question of the extent to which current development strategies rather than ameliorating the sources of tension, may in fact reproduce them through accelerated processes of Sinhalisation, something that is of potent significance for development donors. On the one hand, it is difficult to envisage the short-term revival of opposition and resistance to the current government or to imagine a swift reversal of the expansion of the 'rainbow coalition' in the current context. On the other hand, political authoritarianism, the crackdown on the opposition including particularly on Sarath Fonseka and the JVP, and failures in the area of power-sharing are almost bound, if history is our guide, to stimulate discontents in both the north and east and the south.

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<sup>55</sup> Hague and Miliband addressed the event, whilst the others sent letters welcoming the launch of the organisation.

<sup>56</sup> As already mentioned the most prominent and visible of these asylum movements is the recent spate of 'boat people' arrivals to Canada's shoreline.

## SECTION TWO: THE ECONOMIC LANDSCAPE

### 2.1 Introduction

The first Rajapaksa presidency of 2005-10 was largely dominated by the return to war against the LTTE, and the quest for a stable domestic parliamentary base. With the successful conclusion of the war in May 2009, and having won a heavy majority in parliament in the April 2010 elections, the government has now demarcated the economic sphere as the central focus of policy attention and ambition. The president's 2010 election manifesto, *Mahinda Chintana*, notes:

Over the next six years, I will dedicate myself to increase our per capita income to well above US\$4,000, thereby placing our country in the ranks of middle income nations. The fact that we were able to achieve a sustained and uninterrupted growth in a most challenging era while facing the ongoing conflict was an amazing achievement. I am therefore confident that we will be able to now maintain a continuous growth rate of 8% per annum, during the next six years (Mahinda Chintana page 8).

The first page of the manifesto describes a new 'economic war' to be waged, and gives priority to two key headline targets over the next six years (i) a doubling of per capita income from US\$ 2,000 to US\$ 4,000; (ii) steady eight percent rate of economic growth. Indeed Sri Lanka's economic position has significantly improved in the short post-war period (from mid 2009 to end 2010). The balance of payments crisis that emerged in the first quarter of 2009 was averted with IMF assistance, and inflation rates, which were above 23 percent in 2008 returned to low single digits by the end of 2009. Finally, the improvement in global economic conditions since the financial crisis of 2008 has led to an improvement in exports.

Nevertheless, there are many aspects of the government's economic policy and approach towards achieving these goals that remain undefined. An analysis of the latest budget presented in November 2011 (see Annexure on current macroeconomic position and budget) raises questions about the achievability of fiscal targets and the targeted economic growth. Furthermore, the realisation of the government's economic goals requires improved professional competence in the decision making and economic policy management hierarchy. The Rajapaksa government has now committed itself to being measured by the yardstick of economic improvements in the coming years. This is a change from the previous five years, when the government asked to be judged on the basis of its military success. Political support based purely on ideological motivations, if not followed by improvements in social outcomes and material prosperity, can have a limited shelf life. This shift in the government's declared goals is therefore relevant for the deliberation and decision making by those engaged in domestic politics, international investors, donors and regional powers.

This section provides an analysis of the economic landscape, achievements and prospects in post-war Sri Lanka at the beginning of the second Rajapaksa Presidency. It provides an analysis of (a) the emergence of the economic policy agenda, (b) the dynamics between declared policies and the actual actions or outcomes, (c) changes in economic indicators over the last five years – with a deeper look at developments in employment and poverty, (d) how the economy is poised for the second term of the Rajapaksa Presidency. The analysis also draws attention to the nodal linkages between economic policy, economic outcomes, and the political space.

### 2.2 Historical Context of Economic Policy

Sri Lanka's economic structure is a hybrid, many layered structure that reflects the impact of successive generations of economic policy-making and developmental paradigms. As a broad historical summary of the present landscape: peasant agriculture, which was the mainstay of the pre-colonial economy and society, was superseded and sent into relative decline by the late-19<sup>th</sup> century under the impact of large-scale capitalist export-agriculture in tea and rubber (Roberts and Wickremaratne 1973; Snodgrass 1966). In the mid-20<sup>th</sup> century, concern over this decline of the indigenous peasant population and economy led the newly

democratised and independent country to invest a significant amount of resources to preserve and expand small-holder agriculture through the irrigation and colonisation of under-populated lands in the dry zone (Farmer 1957). At the same time, there was also a broad expansion of state-led welfare provision and of the economic role of the state in society in the first three post-independence decades of 1940s-70s, through the expansion of the public sector and public services such as free health and education (De Mel and Ranan-Eliya 1997; Jayawardena et al 1987).

In the late-1970s, the UNP government of J.R. Jayawardene initiated a sweeping shift in the policy landscape from a state-led to a market-led development paradigm. This resulted in closer integration (or re-integration) of the Sri Lankan economy into the global economy, and the rise of entirely new sectors such as apparel export-manufacturing and tourism, alongside the expansion of the service sector in general, including financial services (Athukorala and Jayasuriya 1994). The market reform paradigm was pursued by successive governments even after the defeat of the UNP in 1994 to Chandrika Kumaratunga's left-centre People's Alliance (PA) coalition – albeit with a 'human face'. Privatisation was accelerated with the setting up of the Public Enterprise Reform Commission (PERC), large entities such as a Sri Lankan Airlines and Sri Lanka Telecom were significantly privatised and the role of the public sector in the economy was gradually and purposefully reduced.

Lastly, the civil war since 1983 has itself become a significant feature of the re-orientation of the economic landscape in the market reform period. The defence budget has increased steadily since the 1980s at a time when the role of the state in the economy has been reduced. Military spending has created strong vested interests in the business sector due to procurement commissions and contracts, as well as in the rural sector due to employment creation (Venugopal 2011a), substituting in part for the need to provide welfare transfers and coalescing rural sector support for the military enterprise and for governments that championed the welfare of the soldier.

The structural context of the Sri Lankan economy reflects the co-existence of these historically layered and interlocking elements: small-holder agriculture, estate agriculture, irrigation-colony agriculture, the public sector/public services, garment exports, tourism, services, and the security sector. The Sri Lankan economy as a whole has grown and transformed along a non-linear and unfinished trajectory from state to market and greater regional and global integration, resulting in increased opportunity from and also vulnerability to mechanisms and processes outside the direct control or ken of the state – such as labour migration, oil markets, international commodity prices and accumulated public debt.

#### *Capitalising on UNP policies 2002 – 2004 and filling a political vacuum*

The UNP/UNF won the forced general election of December 2001, and assumed control of economic policy for the next two years. Almost immediately it attempted to push forward along many axes of unpopular policies, simultaneously: public sector recruitment was frozen, the public sector pension scheme was discontinued for future employees, the fertilizer subsidy to farmers – though costing only around 2 billion – was scrapped, government expenditure was reduced, a dramatic tax amnesty package – estimated to lose revenue in the order of 100 billion (later challenged in the supreme court) – was offered to the private sector, including to even those who were then under litigation for tax evasion.

The UNP had the historical disadvantage of being seen as the party that favoured the business community, and as being unsympathetic to the plight of the poor. Its immediate actions significantly heightened this perception. This palpable neglect of negotiating the different social, economic, political and identity interests in Sri Lanka is an important factor behind the failure of the UNF 2002 - 2004. In April 2004, barely two and a half years since being voted in, the UNF faced electoral defeat to the United Peoples Freedom Alliance (UPFA) (Venugopal 2009).

The convergence of both the major parties towards a consensus on market reform policies in the 1990s created a political vacuum in the space for the economic left. This created an opportunity for Mahinda Rajapaksa's presidential campaign in 2005 to capture this political space and capitalise on popular opposition to privatisation

and the atrophy of the welfare state. This rhetorical opportunism has continued to the November 2010 budget speech, which in its preamble positions the government as being against ‘neo-liberal’ economic policies.

## 2.3 Economic Policy and Management 2005-2010

The economic policy journey from 2005 to 2010 has seen many experiments and reversals. For the most part economic policies have remained in favour of increased openness, greater subjection to market forces, expansion of trade and more involvement of the private sector. The post-war economic policy agenda of the government can be examined by looking at the three overlapping questions of *Intent*, *Competence*, and *Fluidity*.

### Intent: Rhetoric versus Reality

What is the relationship between stated government plans and the actual priority accorded to specific policies? Policy-making and announcements in Sri Lanka, as elsewhere, reflect multiple, often competing objectives and responses to a variety of constituencies and pressures. For example, an April 2010 election promise to increase public sector wages by Rs. 2,500 was not delivered in either of the two subsequent budgets of June 2010 or November 2010. A large number of economic promises made in the election manifesto relating to farmers, children, and other specific groups have not been translated into action. Nevertheless a number of issues that did not feature at all in the election campaign, the manifesto, or in the public sphere at all – such as the content of the 18<sup>th</sup> Amendment to the Constitution (September 2010), or the Casino Regulatory Bill (November 2010) – have since been formulated with clarity and precision, and have been legislated with urgency and with the full political weight of the executive. In short, public pronouncements and documents on the economic agenda are often an imperfect guide to understanding either legislative intent, budgetary priorities, or the sequence of implementation.

At various points, *Mahinda Chintana* identifies a historical rupture between the pre-Rajapaksa market reform period (1977-2005) in its entirety and the post-2005 Rajapaksa era, despite the fact that Rajapakse himself was a leading member of the Peoples Alliance (PA) government from 1995-2001, and 2004-05. For example, the privatization agenda has effectively been disbanded, and there have been no privatizations under the UPFA. On the contrary, there has been the re-nationalisation of the privatised equity component of one partially privatized firm (Sri Lankan Airlines), and the establishment of another public sector airline (Mihin Lanka). The public sector has expanded in size from 1.1 million to 1.3 million over 2005-09, with a small, but discernible reduction in private sector employment (CBSL various). But beyond such policy changes and shifts in emphasis, the Rajapaksa government’s record since 2005 indicates more continuities than a change of paradigm from market back to state. A significant part of the increase in state employment and the size of the state as a whole relates directly to the war, and to the largely unavoidable fiscal expansion that it caused. For example, the increase in the state employment includes the growth of military employment in the post-2005 period of Eelam War IV. Recurrent expenditures in 2009 on Defence, Public Security and Law and Order amounted to 21 percent of total recurrent government expenditures.

Beyond the expansion into airlines, the only area in which the size and reach of the public sector is increasing to a significant extent in contemporary Sri Lanka is infrastructure. A significant portion of the actual and proposed post-war transport and economic infrastructure investment underway – including roads, ports, airports, and railways - is financed and implemented by the governments of China and India, and their public sector corporations, rather than by private sector entities, or by public-private partnerships. The government’s greater emphasis on infrastructure, and on ‘hardware’ rather than ‘software’, has also been partly responsible for the change in Sri Lanka’s aid donor profile as explored in Section Three.

Indeed, beyond a largely populist rhetorical commitment against neo-liberalism, there is no grand transformation of the economic paradigm away from market based, private investment-led growth (also see Annexure on macroeconomy and budget). The main difference is the assertion of state and political power to shape economic

activity and outcomes – ranging from greater political interference in regulatory authorities, direct political pressure on the financial sector, and enlarging the role of the state involvement in economic infrastructure.

## Competence

Does the government have the capacity and competence to deliver on its economic ambitions? Many elements of the economic agenda have been painted only in very broad brush-strokes, and do not exist as a coherent and fully thought through plan. There are several incidents in the 2005-2010 period which lead to questions over government competence in economic policy and management:

**(i) Inflation Management:** In the face of growing inflation between 2005 and 2008, the Central Bank failed to adjust policy rates and allowed inflation to rise to 23.4 percent by October 2008. This resulted in high commercial interest rates on both deposits and borrowing, which in turn led to higher rates of default and the collapse of a number of financial institutions.

**(ii) Exchange Rate Management:** Between March 2008 and March 2009 Sri Lanka's foreign reserves were depleted because monetary authorities pegged the rupee to the US dollar at values not supported by the economic fundamentals – high inflation had depreciated the real exchange rate. As the defence was defeated by market pressures the SLR/USD exchange rate underwent volatile movements from 108 to 119. In the process monetary reserves were depleted by about US\$ 2.3 billion to a low of US\$ 1.2 billion or just 1.2 months of imports, resulting in a balance of payments crisis.

**(iii) Market Risk Management:** Sri Lanka has not had mechanisms to manage the market risk of commodity imports. Between 2002 and 2006 the average US dollar price of a barrel of oil increased almost threefold from 22 to 68; in that time, Sri Lanka's oil bill rose from about US\$ 800 million to around US\$ 2.2 billion. Under advice from government finance professionals and the Central Bank in 2007, the Ceylon Petroleum Corporation adopted inappropriate contracts to hedge the purchase price of oil. The discovery of vast losses resulting from the contract as oil prices came down in 2008 led to the government reneging on the contracts, which has placed it in expensive litigation by international banks in international arbitration proceedings. The result is the absence of a price volatility management, and financial losses to local banks that are not able to challenge the government's default.

**(iv) State Corporations Management:** A new public sector budget airline called "Mihin Air" – named after the President - accumulated up to Rs. 3.2 billion in losses in the first year of operation and then received a Rs. 6 billion bailout from the treasury, to return from bankruptcy. It has continued to increase its operational losses even since.

The mismanagement of Mihin Air had a domino effect. It caused the near collapse of Lankaputra bank, which was floated as a bank that would lend to the poor, but was used to finance the airline as well with 400 million rupees that became a non-performing loan – where again the treasury intervened to inject that sum and rescue the bank. The government then moved to buy back profit making Sri Lanka Airlines into full public ownership in 2008, and use it to subsidise Mihin Air. Since then Sri Lankan airlines has started making record losses – a 12.2 billion loss in 2009 – and both airlines have been subsidized by the budget, specifically exempting them from normal taxes due to the government (Budget 2010/11).

Similar issues plague other state corporations.<sup>57</sup> There have been questions raised about the key officials that presided over the above management failures, several of whom continue to hold those offices with strong support from the executive.

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<sup>57</sup> In 2009 just operating losses alone (without accounting for depreciation and capital losses) were as follows: Ceylon Petroleum Corporation 12.3 billion; Ceylon Electricity Board 7 billion; Sri Lanka Transport Board over 5 billion; Railways 4.8 billion; and the postal department 2.5 billion.

## Fluidity: Responding to credible threats

**Fluidity:** Government policies and actions are invariably more pragmatic, dynamic and susceptible to internal and external pressures than is generally indicated by rhetoric. This can work both favourably and unfavourably in terms of policies towards the poor and marginalised, depending on the source and nature of the pressures faced. Despite being characterised as stubborn, unyielding and nationalistic, between 2005 and 2010 the government has also demonstrated significant ability to negotiate and change its positions in the face of credible, negotiable threats against its interests.

**Policy on IMF:** In February 2007 the IMF shut its office in Sri Lanka after a period of sustained criticism from government ranks. Before and after this period, government and finance officials repeatedly asserted that Sri Lanka was not in need of IMF assistance. When the balance of payments crisis required it to seek urgent assistance, however, the government was nevertheless swift to re-position its rhetoric and fully embrace the IMF, including its conditionalities in 2008-09. The government has since stuck firmly by that renewed relationship, despite being mocked by opposition politicians, even after the balance of payment crisis eased after the end of the war in 2009. The latest budgets have also strongly reflected the commitments to conditions for support agreed with the IMF.

**Inflation Management and GSP+ negotiations:** The spiralling inflation in 2008 also led to a corrective response. The Central Bank has since shifted away from mere quantitative targets to including inflation targets to prevent the threat of high inflation in the future.

Rhetorically, the government maintained a strong front that GSP+ trade concessions were not important to Sri Lanka, and accused the European Union of trying to control domestic laws and policies since the concessions were tied to various improvements in social and political rights. However, behind the scenes, the government engaged in confidential negotiation to try and retain the concessions from the EU and demonstrated significant compromises on social and political issues. These included the early release of IDPs from incarceration and providing a presidential pardon to journalist J.S.Tissanayagam. In this regard the government also entertained the suspicion that the threat, in addition to being credible, was also effectively *non-negotiable*. i.e. that EU would raise the bar of concessions to ensure failure. The government did fail to make adequate compromise to retain the concessions. But not before demonstrating significant flexibility, despite the suspicions it harboured about the EU.

## Resulting scenario

From mid-2006 onwards, there was an expectation among many domestic and international observers that the Rajapaksa government's military approach to the ethnic conflict would prove too expensive, creating severe fiscal pressure, high inflation, and a balance of payments crisis that would have strong repercussions on the real economy through reduced investment, employment, and growth in key sectors. In turn, it was expected that an economic crisis of this kind would politically weaken the government to the extent that it would force significant changes – either to the advantage of domestic political opponents – or in the sense that it would permit the western powers and aid donors the leverage to intervene and gain greater influence to moderate the government's military approach.

Many elements of this scenario became manifest in mid-2008, at a time when the war in the north was entering its final phase. The global financial crisis triggered by the collapse of leading US investment banks in September 2008, together with heightened negative international media exposure of the war in 2009, led to a rapid reduction in foreign investment in Sri Lanka. Inherent structural weaknesses were exposed, as the mismanagement of inflation and exchange rates described above added to the intense pressure on the economy. Nevertheless, the fluidity of policy and the resulting ability to withdraw from ideologically-framed positions has enabled the Sri Lankan economy to draw back from crisis despite the government's otherwise chequered management of economic policy during the 2005-2010 period.



The crises eased quickly following the end of the war in May 2009, when inflation was brought under control, and a 20 month Stand-By Agreement (SBA) was approved by the IMF to provide balance of payments support, subject to a number of phased performance criteria and policy targets being met. The IMF noted the need to address ‘fundamental policy weaknesses’ in Sri Lanka, particularly high budget deficits and external imbalances.<sup>58</sup>

The end of the war and the approval of the IMF’s SBA by mid-2009 created the conditions that could be conducive for a sharp bounce-back in the Sri Lankan economy. There is improvement in the domestic security situation, greater freedom of movement and the perceptions of improved economic and political stability. Since it was starting from a low war-time base, the Sri Lankan stock market boomed to become the best performing stock market in Asia during 2010.<sup>59</sup> In addition, many large Sri Lankan blue chips including Hayleys, Sri Lanka Telecom, Aitken Spence, and John Keels have reported strong financial results for 2010. The Sri Lankan economy is widely projected as having been a success in the past five years despite the challenge of fighting and financing a war. This success is based on two statistics – the increase of per capita incomes from US\$ 1,062 (in 2004) to 2,053 (in 2009); and the reduction of poverty from a head count index from 22.6 percent (in 2002) to 7.2 percent (in 2009). Both of these statistics must be processed with care, as they misrepresent the ground reality. While there are many positive developments in the economy after the end of the war the analysis that follows argues for caution with regard to optimism about the Sri Lankan economy in the next 5 years.

## 2.4 Employment and Poverty

### Employment

In the decade since 2000 there has been a significant expansion of labour migration and migrant remittances. Remittances, which amounted to 23 percent of the value of total exports in 2000, had grown to 47 percent of exports by 2009. Almost one quarter of Sri Lanka’s total labour force is employed overseas, a number that has grown sharply from 13 percent in 2000 (CBSL 2010: table 3.13). Furthermore employment in Sri Lanka has been on the decline, even while the economy shows growth, creating the paradox of jobless growth.

Decline of the farmer: One of the most statistically evident trends in Sri Lanka since 1990 has been the precipitous decline of small-holder agriculture. Following the end of the grand irrigation-agriculture schemes that dominated development policy in Sri Lanka from 1935-90, the share of agriculture in national income and the percentage of the work-force in agriculture have steadily declined. Between 1990 and 2009, the share of the workforce in agriculture (this data includes estate agriculture) dropped from 47 percent to 32 percent, while the share of agriculture in national income dropped from 26 percent to 13 percent.<sup>60</sup> Furthermore, the income share has declined faster than the percentage of work force, reducing the relative average per-capita benefit of working in this sector over the industrial and service sectors. This macro-level evidence is well matched by micro-level survey data from the Household Income and Expenditure Survey (HIES) or the Consumer Finance and Socio-Economic Survey (CFS), which have consistently demonstrated that economically undiversified small-farming households are among the poorest groups in the country, while data on the cost of cultivation show that many food crops such as paddy are un-remunerative for small farmers, and are produced at a loss (Department of Agriculture, various).

Emergence of the Soldier: This substantive decline of farmer also fuelled, in the past, a need to constantly address political speech to the *importance* of the farmer, identified as the ‘ideal citizen’ and placed on a pedestal, even as he was immiserated. A classic example of this was former president J.R. Jayawardene’s use in Sinhala of Robert Knox’s famous quote: ‘if you wash the mud off the Sri Lankan farmer, he is fit to be a king’. Since 2005 given the declining numbers in farming and the increase in military recruitment, the Rajapaksa government, for a

<sup>58</sup> Government of Sri Lanka, June 2008, Letter of Intent to the International Monetary Fund.

<sup>59</sup> The All-Share Price Index (ASPI), the broad stock market index, increased by a multiple of three times in the sixteen months between the end of the war in May 2009 and September 2010.

<sup>60</sup> Department of Census and Statistics, Statistical Abstract 2009.

while, worked to change the casting of the ‘ideal citizen’ in post-war Sri Lanka, from the farmer to the *ranaviru* or ‘brave soldier’.

**Political Pressure:** This contrast between the growing prosperity of globally connected sectors of the economy and the persistent poverty of the rural economy (symbolised by the small paddy farmer and the soldier) is a useful metaphor against which the politics and policy-making of market reform in Sri Lanka can be framed. On the one hand, governments since 1977 have sought to promote and benefit from the sources of global growth, while being required to protect the electorally empowered, but impoverished rural sector. Market reforms have often proved to be politically challenging to implement unless counter-balanced by a commensurate measure of poverty alleviation, rural development or other such compensatory mechanism to address the widespread public perception that they disproportionately benefit the wealthy and harm the poor (Venugopal 2011b).

**Jobless growth:** Sri Lanka’s economy has, despite impressive growth, been shedding jobs. The unemployment rate of 5.7 percent in 2009 is up only slightly from 5.2 percent in 2008, but is due to a drop in the numbers seeking jobs, not an increase in employment.<sup>61</sup> At the end of 2009, total employment in Sri Lanka was 7.14 million or 378,000 less jobs than the economy had in 2005.<sup>62</sup> A disaggregation shows that the public sector increased employment by 209,000 (an increase of 19 percent), while the rest of the economy shed 587,000 jobs. There was a large employment ‘shock’ upon the return to war in 2006, when 454,000 private sector jobs were lost.

Jobless growth could imply large gains in productivity, but if so, sources of such productivity gains remain to be identified. This is a puzzle that deserves further attention in future policy making and engagement in the Sri Lankan economy. A serious possibility to consider is that Sri Lanka’s growth statistics are over-estimated, due to an under-estimation of actual inflation. This has relevance to understanding the puzzle with regard to poverty statistics as well and will be discussed further in the next section.

**Table 1: Employment Trends**

	2005	2006	2007	2008	2009
<b>Total Employment</b>	7,518,000	7,105,000	7,042,000	7,175,000	7,140,000
<b>Public Sector Employment</b>	1,104,243	1,145,723	1,196,610	1,251,728	1,313,584
<b>Private sector Employment</b>	6,413,757	5,959,277	5,845,390	5,923,272	5,826,416

Source: Central Bank Annual Report for 2009

## Poverty

**Historical context:** Sri Lanka experienced a historical reduction in economic and regional inequality under the impact of state-led welfare policies in the 1950s-70s, and a sharp increase in inequalities in the post-1977 market reform period. Inequality grew steadily since the late 1970s, but at a particularly sharp increase in the 1990s to 2002 period, as high rates of economic growth were matched by very low rates in poverty reduction (Narayan and Yoshida 2005: table 6).

During these years, the consumption of the top quintile of the population increased by 50.4 percent, while that of the bottom quintile increased by just 2.2 percent. Per capita income increased in this period by a total of 45 percent, but it had a marginal impact on the poverty headcount, which went down just 3.4 points from 26.1 percent to 22.7 percent. This too, was overwhelmingly concentrated in urban districts such that the poverty

<sup>61</sup> Economists define unemployment as the percentage of *job-seekers* (not population) that is not employed.

<sup>62</sup> These numbers don’t include the north and east – the two provinces most affected by war

headcount was either the same or had increased in 9 of 17 districts during the 1990s (excluding the north and east).

A disproportionate share of the growth in this period was concentrated in the Western region around greater Colombo, which increased its share of national GDP from 40.2 percent to 49.4 percent between 1990 and 2000 (World Bank 2004: i). The growth also accrued largely to the industrial and service sectors. In contrast, there is evidence of a rapid decline in the agricultural economy, as noted earlier.

Within this context of increasing inequality and stagnant poverty since the late-1970s, it has been surprising to economists studying Sri Lanka that survey data now shows a precipitous decline in poverty since 2002.

**Table 2: Poverty Headcount Index**

Sector	2002	2006/07	2009 (provisional)
Urban	7.9%	6.7%	6.5%
Rural	24.7%	15.7%	7.7%
Estate	30.0%	32.0%	9.2%
<b>Sri Lanka</b>	<b>22.7%</b>	<b>15.2%</b>	<b>7.6%</b>

Source: Department of Census and Statistics, Poverty Indicators, March 2008, and November 2010.

Changes from 2002 to 2006/7: Data from the 2002 and 2006/07 rounds of the HIES (excluding the north and east) show poverty declining from 22.7 percent to 15.2 percent. The gains are concentrated in the rural sector (falling from 24.7 percent to 15.7 percent), while in the estate sector poverty worsens from 30 percent to 32 percent over the five year period. Districts such as Hambantota, Matara, Galle, Puttalam, and Polonnaruwa registered a drop of half or more in the poverty count over this brief period. In contrast, the poverty headcount in Nuwara Eliya went up from 22.6 percent in 2002 to 33.8 percent in 2006/7. No commensurate data are available for the north and east, but there is anecdotal evidence that describes the visible increase in economic activity and improvement in living standards during the cease-fire period.<sup>63</sup>

Changes from 2006/7 to 2009: The provisional data released by the department of census and statistics for 2009 (at the aggregate level, as the surveys have not been completed to compile district level data) show a sharp reduction in poverty in the estate sector from 32 percent (in 2006/7) to 9 percent in 2009, which is a drop of 23 percent in the poverty headcount index in the space of three years. Furthermore, the data show a halving of poverty in the rural sector from 15.7 percent to 7.7 percent over the same period. As a result national poverty levels are reported to have halved from 15.2 percent to 7.6 percent.

Deconstructing unexpected shifts: These reported changes in the incidence of poverty are unexpected and puzzling. While no detailed analysis has been conducted to explain these results, several over-lapping explanations have a measure of plausibility:

- (1) The persistence of poverty in the rural south has historically been identified with households that relied primarily on small farm plots for their livelihoods. A drop in poverty in this group would require a broadening of incomes to off-farm employment, and to diversification outside the rural sector altogether such as overseas migration, military employment, and the garment sector (Dunham and Edwards 1996). The data show that military employment increased by around 200,000, and that annual worker migration has averaged around 225,000 a year since 2005 (International Migration Outlook Sri Lanka 2008). The estimated stock of migrant workers (after adjusting for returnees) has also increased in 2006 and 2007 by over 400,000. This estimation of increased migrant stock matches with the data on increased remittances, and is likely to have a larger impact than military recruitments on increasing the consumption ability of households.

<sup>63</sup> Sri Lanka Department of Census and Statistics, derived from HIES 2006/07 data.

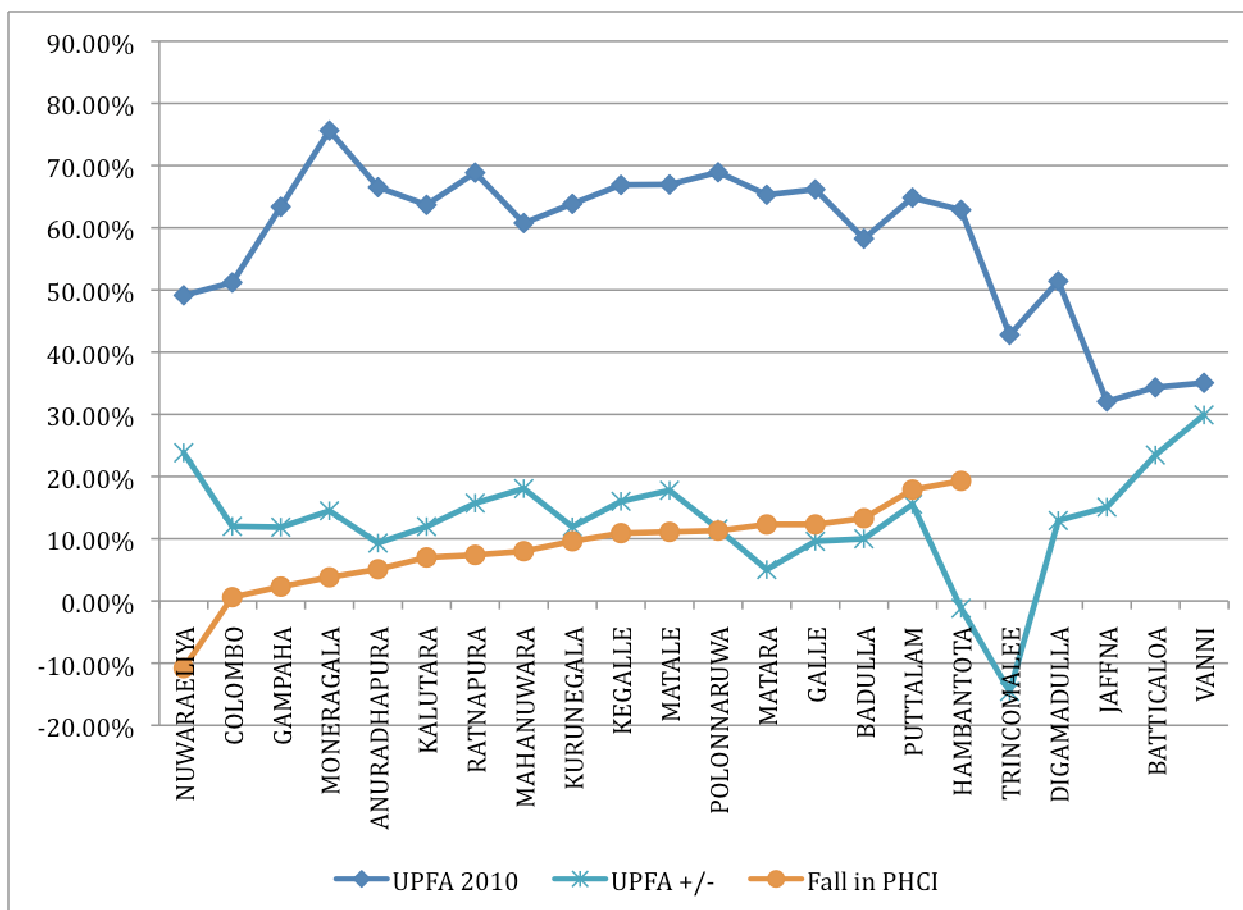
- (2) The 2002- 2006/7 drop covers the peace process period, when there was a relaxation of security measures and restrictions, greater freedom of movement and commerce, an overall increase in economic activity and movement, and significantly higher revenues in certain sectors such as tourism. This would have had effects in the border districts such as Puttalam or Polonnaruwa, while tourism would have been of relevance to the southern province.
- (3) Following the December 2004 tsunami disaster, large aid inflows and reconstruction efforts generated significant multiplier effects in the local economies of the affected coastal areas: the Eastern and Southern provinces – and although there is no data from the Eastern province to corroborate this, the strong reduction in the poverty count in the Southern province could reflect the impact of this one-time effect.
- (4) In 2006 the Central Bank replaced the existing measure of inflation, the CCPI, with a new measure called CCPI(N) – Colombo Consumer Price Index (New). The CCPI(N) used 2002 as the new base year (CCPI had 1952 as the base year), and it changed both the composition and the weight of the basket of goods that were considered for the measure of inflation. Both the CCPI indexes are based on prices in Colombo. The CCPI(N) was then used retrospectively from 2002 to calculate the poverty line. The sudden decreases in poverty would be well explained if this new CCPI(N) is underestimating price inflation – especially in the rural sector.

When inflation is under-estimated, the increased value of consumption and production due to increases in price is reflected incorrectly as an absolute increase in consumption and production. This would also help to explain the unexpectedly high growth figures reported in the last five years, despite the intensification of war and the drop in employment levels. When inflation peaked in 2008 at 23.4 percent on the CCPI(N), economists claimed that on the CCPI, inflation was in the order of 30 percent - a six to seven percent difference. Such differences compounded over the years would result in significant underestimation of the cut-off income that determines the poverty line -- which is presently extrapolated on the basis of the 2002 HIES survey, using CCPI(N) – leading many poor to be wrongly classified as non-poor.

In sum, there have been some extraordinary developments, such as tsunami aid flows, increased migration, the investment optimism of the short-lived peace process, and after that increased military recruitment, which could partially explain the reported reduction in poverty. However, it is likely that inflation measurement discrepancies since 2002 provide at least part of the explanation for the unprecedented magnitude and volatility of the reductions in poverty levels in the estate and rural sectors. A resolution of this question will be possible in the future when the poverty line is recalculated directly from actual price data as it was for 2002.

Poverty and Politics: Concerns about the accuracy and volatility of poverty data add some uncertainty to the robustness of any analysis with regard to the inter-connections between changes in poverty and changes in political support. The problems can be overcome to some extent by focusing the analysis on relative changes in poverty between districts vs. the relative change in political support.

### **Figure 1: Poverty Reduction vs. Vote Share for the UPFA**



Analysis of the available data shows that: (1) The UPFA has been favoured in districts that are relatively poor. (2) The gains in UPFA votes between 2005 and 2010 are not positively correlated (in fact negatively correlated) with the relative gains in poverty in those districts. i.e. while the UPFA has a higher popularity in the poorer districts of the country, the subsequent gains in popularity are not related to its achievements in reducing poverty.

.The result that poverty reduction is negatively correlated with increased votes is counter-intuitive.<sup>64</sup> One way to understand this is to recognise that the relationship between economic outcomes and political outcomes is not based on a direct causal link, but are mediated through ideology and institutions. The nature of the mediation matters.

Between 2005 and 2010, the UPFA government made ideological rather material promises. Sinhala dignity, unifying the nation, resisting external interference, and restoring the pride of the military, were the primary pillars upon which the UPFA built political support. The UPFA invited people to tighten their belts and accept higher taxes and higher prices in order to win in the theatre of war – as indeed it did. For the political term starting in 2010, however, the yardstick of economic improvements will prove to be more demanding.

<sup>64</sup> A regression analysis was used to check on the relationship between UPFA votes in 2010 and reduction in poverty – because the reported correlation of 0.469112 would be biased by including the effects of entrenched support for UPFA in the poor areas. Two linear regressions were also used to test the correlations. Both show a negative relationship between reduction in poverty and vote share in 2010, affirming the robustness of the counter-intuitive result that poverty reduction is negatively correlated with support for the UPFA.

## 2.5 Post-war challenges and an agenda for the economy in the north and east

The greater part of the policy tasks that face the present government have been shaped within a structurally constrained, path-dependent context that is largely inherited, and that would have confronted any elected Sri Lankan government. In addition however, the emergence of the north and east from conflict poses some very specific challenges to development in those regions.

### North and East Post Conflict Economic Challenges.

A communication to the donors by the Ministry of Economic Development headed by Basil Rajapaksa emphasised the importance of long-term development and infrastructure development over capacity building and livelihoods programming – which can be described as a preference for ‘hardware’, rather than ‘software’.

This is in many ways a reversion to the traditional role of development aid of the 1950s and 60s, as a largely economic tool designed to overcome a critical shortage of domestic capital mobilisation and thus to engender rapid economic ‘take-off’. Many traditional OECD bilateral donors and the World Bank pursued such an approach at the time, but have since the 1980s transitioned towards less capital intensive issues such as governance, human rights, education & capacity-building, poverty alleviation, and conflict prevention.

The end of the war creates some very specific and unique issues for economic development in the north and east of Sri Lanka. These areas, due to long conflict, have been subject to trauma and deprivation not experienced in other parts of the country. Restoring the economies of the north and east involves not just “equalising” opportunities for economic competition between the north and east and the rest of the country, but paying attention to easing the capacity constraints that can prevent the people of the north and east from competing in a national and international market economy.

Four kinds of developmental challenges for the ‘post war’ north and east can be identified:

- (i) **Restoring public goods:** Restoration of law and order and public services such as health and educational facilities.

This includes dismantling the operation of para-military or mafia type forces tied to the political and security establishment. Our field work in Jaffna elicited many complaints about the existence of such forces tied to post-conflict military and political powers. Interviews revealed that restoration of health and educational facilities were progressing more positively in the city of Jaffna, although there remained severe challenges especially in the war affected Vanni regions south of Jaffna.

- (ii) **Restoring trade and livelihoods:** i.e. restoring physical capital, communication infrastructure, land and labour force into production activities.

Both the north and east have benefited from improvements in transport and the entry of private mobile phone and banking services, which has led in turn to improvements in communication and financial services. Incentives have been put in place by both the government and donor funded projects to encourage employment-generating industries in these regions. However there is also significant alienation of land for security purposes, and displaced returnees have not been provided with adequate means for subsistence or livelihood formation. Furthermore these areas also suffer from a lack of education and skills, which require corrective intervention to avoid the clustering of employment opportunities at the bottom of the wage scale.

- (iii) **Restoring social infrastructure:** i.e. restoring civil institutions, social values, and support networks.

The strongest complaints made by people in the north and east relate to the break-down of civil institutions and the heavy interference and monitoring by the military in the functioning of social and civil society groups, which preclude autonomous decision making and planning. Civil society institutions cite the enforced intervention of military representatives presiding over ceremonies that initiate the transfer of economic benefits to the population, and enforced cancellation of public events, if they are suspected to be unsupportive of present policies and governance.

(iv) **Preventing exploitation and inequality** i.e. appropriation of assets from vulnerable groups such as female-headed households, the aged or displaced returnees.

There are several ways in which assets are appropriated away from vulnerable groups in the north and east: (a) Rent-seeking by those with access to state and military power; (b) Appropriation by the military and security establishment; (c) Reclamation of land by those who have long left the war zone and settled elsewhere. It is important to ensure that those recently displaced or presently occupying the land are not rendered homeless or destitute by the above types of appropriation; and that they are not made susceptible to exploitation in low-wage labour, without access to land ownership.

Development incentives and interventions based on increasing support for agriculture-based development should take into account the fact that although agriculture accounts for the vast majority of economic output in the Northern Province (72 per cent), returns to workers in the agricultural sector are much lower than for the industrial and service sectors (IPS 2009). Development assistance should also address the lack of technology, skills and equipment in post-conflict communities. These capacity constraints have, for example, prevented fishermen in the north from competing with rivals from South India or Southern Sri Lanka, who have access to multi-day boats.

## The Economic Agenda

In broad terms, the main economic policy and management issues that confront the government in next five years area as follows: (also see Annexure on macroeconomy and budget):

1. Addressing the weakness in government finances and the persistence of fiscal deficits.
2. Addressing the extended atrophy and under-funding of the public health and education system in Sri Lanka, (including tertiary education and vocational training).
3. Providing a solution to the persistent decline of small-holder agriculture, and the concentration of poverty among small farmers.
4. Fighting corruption and improving the conditions for doing business and investing in the economy.
5. Fostering large-scale investment to address reconstruction in the north and east, and to significantly upgrade the economic infrastructure throughout the country.
6. Addressing the legal, regulatory and institutional gaps that have arisen as a result of the economic transformations of the last three decades.

The persistence of these issues on the policy agenda over the last three decades also demonstrates the deep problems that have plagued economic policy-making from one government to the next. These include the prevalence of weak coalitions, a patronage-based political system, the political cost of implementing unpopular reforms, and the exigencies of war-time policy-making. One of the remarkable features of the post-war scenario is that the Rajapaksa government has the advantage of having overcome many of these obstacles that had held back policy-making in the past; and it possesses the capacity to pursue its agenda with greater vigour and success than recent predecessors. With an end to the war, a strong majority in the legislature, and a long and undisturbed political horizon ahead, the second Rajapaksa government enjoys the kind of masterful command of the political space and policy realm that is comparable only to the early years of the Jayawardene presidency in the late-1970s.

Therefore, the present government has the ability to use its political capital to implement economic reforms that are needed for the long-term health of the economy. Based on the analysis in this section, it will be important to monitor if the second term of the Rajapaksa government succeeds where the first term failed, in (a) finding the competence within the administration to identify appropriate policies, and implement them effectively, (b) managing public sector corporations and spending to stem unsustainable costs and losses, and in (c) overcoming patronage and corruption which skew decision making away from long-term developmental goals towards short-term political expediencies.



## SECTION THREE: INTERNATIONAL ENGAGEMENT

### 3.1 Overview

The following section develops further the external dimensions of Sri Lanka's political economy. As already emphasized, donor roles and potential impacts must be viewed against a wider canvas – they are just one part of a complex picture of external engagement, which has changed fundamentally in recent years linked to the rise of China, the declining influence of Western players and the reorientation of diplomatic ties and economic relations eastwards.

### 3.2 An Eastwards Turn?

Sri Lanka's geopolitical position has evolved considerably, partly as the result of a power shift from west to east and also a conscious attempt by the Rajapaksa regime to reconfigure its global relations (Uyangoda, 2008:25). The contrast between the West-oriented UNF regime and the East-oriented UPFA brings out in sharp relief what many believe to be a decline of the so-called Washington consensus and the rise of an emerging 'Beijing consensus' – or as others have formulated it, the demise of the western project of liberal peacebuilding and the emergence of illiberal peacebuilding, associated with different norms related to sovereignty, democracy and human rights (Lewis, 2010, Goodhand, 2010).

The Sri Lankan government has not been slow to reinforce this perception. The former Ambassador to the UN in Geneva, Dayan Jayatilaka for example wrote that 'the West...is in a slow parabolic decline in relation to Asia, especially in Asia' (Jayatilaka, 2010a). Rajapaksa has repeatedly stressed the significance of Asian countries in helping Sri Lanka win the war and consolidate the peace. The government has justified the centralization of power and its development strategy by referring to Asian development models, exemplars being the four original Tiger economies: South Korea, Taiwan, Singapore and Hong Kong.<sup>65</sup> Also as explored below, Rajapaksa's strategy for ending the war was very much in line with other Asian powers' prioritization of Westphalian principles of non interference, sovereignty and territorial integrity.

The growing role of China in Sri Lanka and the South Asian region more generally is viewed by many as a manifestation of this West-East shift. The so-called 'string of pearls strategy', which started in the 1980s, aims to give China energy security, with refuelling stations around the world (Rehman, 2009). Establishing a network of industrial hubs and ports – with Hambantota<sup>66</sup> being an exemplar – also enables China to project its military and political influence. This in turn has induced geopolitical competition with India, which has concerns about China increasing its influence in South Asia at India's expense. The GoSL has astutely exploited this competition in order to maximize revenue streams and diplomatic support from the two countries.

After two decades of a consciously low-key approach to engagement with Sri Lanka, the end of the war in 2009 brought about a massive expansion in India's role on several fronts: diplomatic, political, relief and reconstruction, and commercial investment. The extent of India's involvement in Sri Lanka, and in the Sri Lankan ethnic conflict has changed very significantly in the last thirty years, as have the policy tools that have been deployed. However, the issues driving this interaction have for the most part remained similar over the years, and can be summarized in the following four factors: (i) regional security concerns, particularly involving Sri Lanka's relations with extra-regional powers that compete with India; (ii) domestic security concerns, particularly relating to the metastasis of non-state militant groups and violent instability to India; (iii) welfare of Sri Lankan Tamils, particularly given the strong electoral compulsions within India's Tamil Nadu; (iv), commercial/investment compulsions in the context of the expanding Indian economy (Rehman, 2009; Destradi,

<sup>65</sup> See Perera, 2010, 15 Nov 'The Challenge of President Rajapakse's Second Term'.

<sup>66</sup> When Hambantota is completed it is likely to have an aviation fuel storage facility and a liquefied natural gas refinery. The first phase will have bunkering facilities to refuel ships that pass the nearby shipping lanes, among the world's busiest. Construction started in Jan 2008 and it is a 15 year project.

2010).<sup>67</sup> Whilst the relative importance of these factors has changed over time, for the most part the first two have tended to be the primary drivers of Indian (dis)engagement in Sri Lanka.

In general terms, domestic security and commercial collaboration are areas where India and Sri Lanka have shared interests and have brought the two governments into closer collaboration. In contrast, international geopolitical issues, and the Sri Lankan Tamil issue are areas of habitual disagreement and tension. The nature and scale of India's engagement with Sri Lanka can be traced to imperatives arising within these four parameters, and the distribution of aid is often a useful metric to understand their relative importance and prioritization vis-à-vis one another. In the post-war period, Indian aid to Sri Lanka has been dominated by the two polar elements within the aid-relief continuum: infrastructure and humanitarian aid, and this essentially reflects India's desire to address two disparate factors: China and Tamil Nadu. Since the end of the war, Indian foreign policy officials have struggled to address Tamil Nadu's concerns, which entail applying pressure on Sri Lanka, against geopolitical pressures to appease and increase infrastructure investment in Sri Lanka. Within these complex and contradictory circumstances, it appears that India will seek to balance its myriad interests by reducing pressure on Sri Lanka for a political settlement - which is increasingly viewed as unfeasible - but increasing more visible forms of aid and assistance and targeting them more directly towards war-affected Tamils.

Although the Eastwards turn in Sri Lanka's diplomatic and development strategy is clear, the extent to which it represents a step change signalling the irreversible decline of Western interests and influence in Sri Lanka can be contested. First, the Eastwards turn was in some respects born out of tactical necessity rather than long-term conscious design. The regime initially appeared to believe that it could depend upon western support once the peace process broke down irredeemably with the Rajapaska administration expecting 'full backing of the Western governments to its own war against terrorism. However the Western backing to the war against the LTTE came with human rights conditionality' (Uyangoda, 2008:25).<sup>68</sup> Therefore to some extent the regime was forced into a closer embrace with Eastern powers and 'non traditional' donors. This suggests that underneath the anti western rhetoric there is a strong strand of pragmatism – in both the foreign policy and domestic spheres – which indicates that the regime is unlikely (and unable) to disengage from 'the West' entirely. Whilst western players represent useful scapegoats, there are too many long standing economic, political and cultural linkages for Sri Lanka to entirely discount western views and sensibilities.

Second, the idea of a sudden Eastwards turn is based on the assumption that China and other non traditional donors are new players on the Sri Lankan scene, which is evidently not the case. Sri Lanka has long cultivated ties with a range of countries in the global south linked to its membership of the non aligned movement. Its relationship with China dates back to 1961 for example and it was a source of foreign assistance in the 1970s. In fact the relationship with China is much older than with many Western countries, although it is true that the current level of engagement is unprecedented.

Third, Western political and economic interests in Sri Lanka have not disappeared, even though the country does not represent a geostrategic priority to the West. In a 2009 US Senate report, it was stated that the 'US cannot afford to 'lose' Sri Lanka' (US Senate, 2009: 3), leading to a call for a more multifaceted strategy capitalizing on trade, economic and security aspects of the bilateral relationship. The US continues to be Sri Lanka's most important trading partner, accounting for more than one quarter of the country's total exports.

Fourth, the idea of a shift from the west to the east implies a clear division between the two in terms of interests, values and approaches, which simply does not exist in practice. The principal geopolitical competition may be less between west and east than within the east, namely between India and China (Rehman, 2009).

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<sup>67</sup> India's exports to Sri Lanka doubled between 2004 and 2008 and total FDI grew from \$54 million to \$126 million in 2008. However the share of India's trade with neighbouring states is minimal. In 2008 India's imports from the whole of South Asia amounted to just 5.1 percent of total imports and only 6.9 percent of exports were to South Asia (Destradi, 2010).

<sup>68</sup> However, it should be noted that some aspects of Western caution vis-à-vis Sri Lanka were only implemented after the war had finished. For example, weapons export licenses to Sri Lanka were only revoked in the latter half of 2009 (House of Commons 2010). The US imposed an embargo in March 2008 (US Federal State Register 2008).

Furthermore, as explored further below, there is limited coherence between western players in their dealings with Sri Lanka.

### 3.3 The changing context of external engagement

In spite of the above caveats, which caution against too simplistic a reading of the 'eastwards tilt', it is clear that Rajapaksa has radically re-engineered Sri Lanka's external relations and this has been central to his project of political consolidation. In order to understand how and why this took place, some background is necessary going back to the previous regime and the peace process.

#### *Peace negotiations followed by 'war for peace'*

For a brief period (2002-2005) there was a convergence between the regime and foreign donors, followed by a fairly rapid divergence. The level of foreign engagement was unprecedented and this soon catalyzed long standing insecurities about foreign meddling, creating an important legacy that continues to infuse relations between western actors and the current regime (cf Goodhand and Klem, 2005; Rampton and Welikala, 2005; Goodhand and Walton, 2009; Venugopal, 2009). Once negotiations broke down entirely and the UPFA embarked on a 'war for peace', regional and international powers were initially sceptical about the war's outcome (Uyangoda, 2010). India and the US were reluctantly willing to back the Sri Lankan state, whilst Japan and EU were less enthusiastic. China, Pakistan and Iran were more unequivocal in their economic, military and political support for the government. Rajapaksa turned to Iran, Pakistan and China for direct military assistance and Libya, Iran, Japan, China and Russia for economic aid. China was by far the largest provider of weapons in Sri Lanka in 2008, accounting for over 80% of total supplies (Destradi, 2010: 19). Rajapaksa also strengthened bilateral ties with China, Libya, Jordan, Burma and Vietnam (ibid). Although loans and grants from western countries fell between 2006-2007<sup>69</sup>, total loan commitments actually increased slightly from \$1 billion to 1.2 billion (Goodhand and Walton, 2009: 312).

However, these ties did not immunize the government from western opinion and pressure, and it is clear that the GoSL were conscious of, and responded to this pressure. The APRC and the IIGEP for instance were arguably designed to deflect international opposition to the conflict. The government also sought to legitimize the war in the north and east, by framing its operations within the discourse of the war on terror and labelling it a 'humanitarian war' aimed at liberating the Tamil people from the 'terrorists'. Defence Minister Gothabaya Rajapaksa described it as the 'world's biggest hostage rescue operation'. A policy of keeping the media out and limiting the access of aid agencies was strictly enforced.<sup>70</sup>

To some extent this 'illiberal counter insurgency' (Lewis, 2010) succeeded on its own terms because of the lack of restraint on part of the military and the willingness to endure high civilian and military casualties.<sup>71</sup> As Lewis (2010) notes, this was very different, on paper at least, from the population-centric counter insurgency strategy advocated by Kilcullen-Petraeus in Afghanistan and Iraq. However, the brutality of the end of the war, in many respects constituted the culmination of an historical process in which the state has increasingly resorted to institutions of violence in order to safeguard state-related social and political interests (Kapferer, 2001:35).

<sup>69</sup> Germany stopped new commitments of development aid and the UK suspended around \$3 million of debt relief. The US's Millennium Challenge Account's commitment of \$110 million to Sri Lanka was put on hold in December 2007 'pending an improvement in the security situation' (cited in Goodhand and Walton, 2009:312).

<sup>70</sup> As candidly noted by Jayatileka, 'It was a neck-and-neck race between the historic chance of finishing off the Tigers and concerted international pressure interrupting the offensive....The international pressure was too strong for the Sri Lankan state simply to ignore but too weak to stop the state's military campaign...We had to outrun the pressure by accelerating the military offensive and closing the endgame as soon as possible' (Jayatileka, 2010b).

<sup>71</sup> Chandrika Kumaratunga, commenting on the Rajapaksa strategy, reportedly said that she too would have been able to win the war if she had adopted this strategy but she could not countenance killing so many of her own countrymen.

Immediately after the war ended the GoSL was quick to recognize the part played by its international supporters. Jayatilleka, talking about the support from India and China during the war for peace stated ‘Without their help, I don’t think we could have ended the conflict.’<sup>72</sup> In his victory speech to the nation on 18 May 2009 Rajapaksa said a new political solution for Tamil rights could not be dictated from abroad: ‘We do not have time to be experimenting with the solutions suggested by other countries’ (cited in Matthews, 2009:580) and he further emphasized Sri Lanka’s relations with China, Iran and India and the G15 group of developing countries.

Ban Ki Moon’s condemnation of the ‘unacceptably high’ civilian casualties prompted denial and a sharp rebuttal from the government (Laferriere & Schaffer, 2009).<sup>73</sup> Drawing upon an old tried and tested political discourse, there was a constant reaffirmation of the concept of ‘internal sovereignty’ and ‘non interference’ – key motifs of the nationalist project to be found in the *jathika chintanaya*, thus reinforcing a hardline Sinhalese political world view *arkalpa* (cited in Matthews, 2009: 583).

### *Post war: adjusting to new political realities*

Following the end of hostilities, western pressure to immediately devolve power away from the centre and to address human rights violations did not dissipate.<sup>74</sup> A special session of the UN Human Rights Council was held in the third week of May which provided a venue for an exchange between the GoSL and western critics. A group of western countries including the UK, France, Canada, Switzerland and Germany called for the special session specifically to discuss allegations of civilian killings. A resolution was passed accusing GoSL and LTTE of war crimes – but the GoSL, represented by Dayan Jayatilleka (permanent representative to the UN in Geneva), successfully organized a counter resolution, in support of its actions backed by India, Russia and a majority of Asian, African and Latin American members.<sup>75</sup> A US state department report on the end of the conflict submitted to Congress in October added to tensions between the regime and the West.<sup>76</sup> But links to China gave the GoSL highly effective diplomatic cover not least at the UNSC and the country strongly opposed calls to an independent inquiry into war crimes

Growing pressure was placed on the government over army run welfare centres, which sparked an outcry from the West and India, leading to pressure on the government to move faster on rates of return, freedom of movement, access to camps and compliance with international standards set forth by the UN.<sup>77</sup> From a GoSL perspective the security challenges of LTTE cadres hiding among IDPs and the risks of land mines<sup>78</sup> in newly cleared areas trumped other considerations. However from October, as a result of coordinated international pressure, there was an acceleration of the resettlement programme and UN agencies were able to access small parts of Mannar and Mullaitvu, where returns were taking place. Furthermore, IMF loan negotiations quickly became part of the political controversy and the US asked the IMF to put Sri Lanka’s request for an emergency loan on hold citing concerns about human rights. Eventually the \$2.6 billion was approved in April 2009 with

<sup>72</sup> Perera, A ‘How Sri Lanka and India displaced the West in Sri Lanka’ Oct 3, 2010

<sup>73</sup> Estimates of the number of civilians killed vary with ICG for example giving a range of between 20-40,000 during the period from mid January to the end of the war.

<sup>74</sup> Within four days of war ending, US Secretary of State Hillary Clinton telephoned the President to personally appeal for the political reconciliation, the speedy resettlement of the displaced and post war power sharing (Uyangoda, 2009:105). This was followed by Indian Foreign Minister S. M. Krishna’s call for the government to ‘now address the root cause of the problem of Tamils that will include devolution of powers to all communities’. In the same week Ban ki-moon visited Sri Lanka to stress the urgent need for early resettlement of IDPs.

<sup>75</sup> The wording of this counter resolution included the following clause: ‘Welcoming the conclusion of hostilities and the liberation by the Government of Sri Lanka of tens of thousands of its citizens that were kept by the LTTE against their will as hostages, as well as other efforts by the Government to ensure safety and security for all Sri Lankans and bringing permanent peace to the country’.

<sup>76</sup> The report prepared by the department’s Office of War Crimes Issues alluded to events during the last phase of the war and alleged serious violations of IHL.

<sup>77</sup> In mid September the ERC stated that the UN was ‘extremely frustrated with the lack of progress in various areas, and the organization was concerned about the military nature of the camps, the lack of freedom of movement and the lack of progress with regard to early return, political reconciliation and accountability (Daily Mirror, 17 Sept, 2009).

<sup>78</sup> An estimated 1.5 million mines were placed by army and LTTE in the Northern Province.

unusually, six countries abstaining from the vote. This came at a critical time when there was a high level of foreign debt, and sent a positive signal to investors.

Tensions further increased over GSP + negotiations, where the key conditions for renewal were progress in labour laws, working conditions in the manufacturing sectors and human rights. An EU assessment was scheduled to begin at about the time the government pressed its military campaign. The GoSL eventually refused to cooperate with the EU inquiry, arguing it constituted interference in its internal affairs and national sovereignty. The EU prepared an interim report based on consultations with trade unions and NGOs which was critical of Sri Lanka's human rights record and opposed extending GSP +. Although as mentioned in Section Two, the government did show a level of flexibility and compromise on certain issues, finally in early 2010 the GSP + privilege was withdrawn, which Rajapaksa dismissed as a 'politically motivated' decision.

After months of speculation, Ban Ki Moon announced in June 2010 that a three member Expert panel to advise on accountability for possible violations during the SL conflict. This followed the government's announcement on May 17 that it had appointed an eight member panel 'Lessons Learnt and Reconciliation Commission'<sup>79</sup> The UN Secretary General's announcement sparked demonstrations in Colombo leading to the closure of the UN compound, and the fasting of government Minister for Housing and Construction, Wimal Weerawansa.<sup>80</sup>

Therefore, there has been a reorientation of Sri Lanka's external relations away from the West, towards Asia and the Middle East (Uyangoda, 2009: 107). This started from the beginning of Rajapaksa's regime but accelerated during the final period of the war against the LTTE. The Rajapaksas have constructed their own version of an 'international safety net', which they have used very effectively to insulate themselves and the military from pressures from western countries over human rights concerns in its pursuit of the final war. In much the same way that international actors attempted to devise ways of dealing with 'spoilers' of the peace process, the GoSL have treated western actors as potential spoilers of its own project of counter-insurgency and militarized development.

Therefore, to some extent the administration has learnt that it can withstand western pressure, when it is poorly coordinated or not sustained. On the other hand there is some evidence that strategically focused pressure may lead to changes in policies as for instance in relation to the release and resettlement of IDPs and more recently the release of ex-combatants and access of the UN and NGOs to the north and east. However, as already noted, there is always a danger that paradoxically, visible western pressure/intervention may strengthen the government's position as a defender of the nation against neo imperial powers. At the same time, one should not overstate the coherence, power and confidence of the current regime or the patience and loyalty of its external supporters. As Dayan Jayatilleka commented, after he left government 'There is a growing deficit of Sri Lanka's 'soft power' and conspicuous failure in the realm of 'the New Public Diplomacy'.....Those who fought alongside us diplomatically during war may not do so in peacetime, especially if that peace drags on without reconciliation and normalcy'(Jayatilleka, 2010a).<sup>81</sup> The issue of war crimes continues to be a thorn in the

<sup>79</sup> The remit of the LLRC was to address the following questions: 1. The facts and circumstances which led to the failure of the ceasefire agreement operationalized on 21st February 2002 and the sequence of events that followed thereafter up to the 19th of May 2009. 2. Whether any person, group, or institution directly or indirectly bears responsibility in this regard. 3. The lessons we would learn from those events and their attendant concerns, in order to ensure that there will be no recurrence. 4. The methodology whereby restitution to any person affected by those events or their dependents or to heirs, can be effected. 5. The institutional administrative and legislative measures which need to be taken in order to prevent any recurrence of such concerns in the future, and to promote further national unity and reconciliation among all communities, and to make any such other recommendations with reference to any of the matters that have been inquired into under the terms of this Warrant.

<sup>80</sup> The UN responded by recalling their country representative Neil Buhne for consultations in New York and closing UNDP's regional office. On July 10, the United States, the European Union, and eight European heads of mission in Colombo issued a joint statement that "Peaceful protest is part of any democracy, but blocking access to the United Nations ... as well as intimidating and harassing UN personnel is a breach of international norms and harmful to Sri Lanka's reputation in the world."

<sup>81</sup> In a further barbed comment about the current government Jayatilleka states that 'A viable option for Sri Lanka would be the Asian model of globalization but the dominant ideology, mindset and policy framework of the incumbent administration is far from the paradigm of the New Asian modernity' (Jayatilleka, 2010c)

government's side and the US has some scope to apply pressure as several senior figures have links to the country and could be subject to US law, with Gotabaya and Basil both holding green cards.<sup>82</sup> However, arguably the window of opportunity for serious international leverage has passed. It was open briefly during late 2008 and early 2009 when the war for peace was far from won, the economy was in crisis and the IMF loan had not yet been negotiated. The window was closed shut by the military victory and the IMF loan coming through, leaving Western diplomatic or financial pressure as perhaps an irritant for the government, but not a source of genuine leverage. Nevertheless, the allegations of 'war crimes' have not entirely disappeared from the political firmament either and they still remain a potential tool that could be taken up by the US in the future.

### 3.4 International donor engagement

#### *Background*

Although as a percentage of GDP, foreign aid has declined,<sup>83</sup> donor support has been strategically significant in a number of areas including: budget support from the IMF; supporting state spending priorities including infrastructure and the promotion of the private sector; helping bridge the external financial gap; humanitarian spending and reconstruction assistance in the north and east. Therefore, whilst Sri Lanka is in no way an aid dependent state, external resources have significant economic and political effects.

Sri Lanka is now a low middle income country and therefore relatively successful in taking care of poverty (see previous section), whilst the country's achievements in the MDGs have been positive.<sup>84</sup> In donor parlance, the country is a 'good performer'. Therefore in terms of social issues confined to poverty alleviation and the MDGs there seems to be a great degree of agreement between donors and the GoSL.

Historically the aid landscape in Sri Lanka has been dominated by the World Bank, the ADB and Japan. In both previous SCAs in 2001 and 2005, this was still the case. However, as already highlighted, in recent years this has changed as a result of the combination of new donors emerging and an increase in commercial borrowing. Overall there has been a shift in the proportion and mix of foreign financing with the result, as argued by Kelemaga and de Mel (2007), that it has become increasingly expensive. First, as per capita income has grown and Sri Lanka has graduated to lower middle income status, levels of concessionary financing have declined, at the same time as the demand for infrastructure related finance has grown. Second, in order to bridge the funding gap, there has been a shift towards 'non-traditional' donors, so there is an economic imperative behind this trend, as well as the political imperative mentioned in the previous section. Bilateral aid from 'non-traditional' donors has a number of features (see below) which means that it tends to be more expensive than multilateral aid, which has declined relatively in recent years. Third, the mix of foreign aid and concessionary and commercial lending has changed with increased reliance on the latter, with obvious implications for foreign debt.

These shifts can only be understood in relation to the current administration's determination to centralize power and to assert 'ownership' over its development agenda. On the face of it there is a major difference between the development visions of the UNF and UPFA regimes, as captured in their two development strategy papers, *Regaining Sri Lanka* and *Mahinda Chintana*. But these differences may be overstated. In many respects the current regime is carrying out the same fundamentals as those initiated in 1977, with a strong dose of nationalism and a rejection of state reform. It is less a rejection of neoliberalism than an Asian variant of neoliberalism.

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<sup>82</sup> Bruce Fein a US lawyer representing Tamils Against Genocide has filed a report with the US Attorney's Office which it hopes will lead to the Justice Department laying charges of genocide, war crimes and torture against Gotabaya and Fonseka

<sup>83</sup> In 2007 aid disbursements were 3 percent of GDP; exports 29 percent; remittances 7.7 percent.

<sup>84</sup> According to UNDP, based on national reporting, the country is 'on track' to meet the goals concerning extreme poverty and hunger (MDG1), universal primary education (MDG2), reducing child mortality (MDG4), improving maternal health (MDG5), combating HIV/AIDs (MDG6). On the two remaining gender equality (MDG3) and environmental sustainability (MDG7) they 'are possible to achieve if some changes are made'.

The major shift is that western donors now have very little influence on the development agenda (Kelegama and de Mel, 2007:17). Part of the history behind this shift is the lesson that the current regime drew from the UNF period. Donors had a relatively strong hand during a period of economic crisis, with an IMF bailout, and when the ruling government had a similar agenda to the Bretton Woods Institutions (Ibid). However, there was a wider perception that the *Regaining Sri Lanka* package was against the interests of the people because it was imposed by the donors (ibid: 19). The surge in foreign aid following the peace process and then the tsunami<sup>85</sup> intensified insecurities about western meddling and a self-interested alliance between Colombo elites and international donors.

With the restarting of the war, there was a dip in western funding.<sup>86</sup> Thus, some significant element of conditionality was being implemented, yet despite these cutbacks, overall aid levels to Sri Lanka increased. This was because the government made an active decision to shift away from concessionary lending from the IFIs in order to achieve greater policy space. The state has focused instead on bilateral funding, largely from non traditional donors, coupled with concessionary borrowing and in so doing Rajapaksa has created considerable room for manoeuvre (Kelegama & de Mel, 2007:16/17).

ODA in Sri Lanka can broadly be divided into the following categories:

*(i) Humanitarian Assistance*

Apart from government commitments (for example food stamps, resettlement grants etc), this largely comes in the form of grants through the UN system, bilateral donors and NGOs. The tsunami response saw a massive injection of humanitarian funding (see below). OCHA was originally established in Sri Lanka to coordinate the UN response to the tsunami and its mandate subsequently changed to incorporate those displaced by the conflict. Funding has grown in response to the humanitarian crisis created by the end of the war with several bilateral donors and multilateral donors stepping up their commitments including the UK, Australia, India, Japan, Netherlands, the EU/ECHO and the US, who in 2009 were the leading donor of food and humanitarian assistance providing \$43.12 million.<sup>87</sup> Humanitarian funding has been funnelled through the CHAP, though there have been moves by the GoSL to establish stronger central control of these resources (see below).<sup>88</sup>

*(ii) Reconstruction/Development in the north and east*

The government policy, first in the east and then the north, has been to move quickly from humanitarian programmes into 'early recovery' and development, as part of its 'stabilization' agenda (Goodhand, 2010). This has involved a combination of grants and loans from multilateral donors (World Bank, ADB, EU, UN), western bilateral funders (USAID, Ausaid, GTZ), non traditional donors (China, EU) and NGO programmes, in addition to commercial lending for larger infrastructure projects including coal stations, railway lines and road building. There has been an emphasis in the north and east on government-delivered programmes (e.g. *Neganihara Navodaya* and *Uthuru Wasanthaya*) with line ministries, private sector firms or multilaterals playing a central role in delivery.

*Country-wide development assistance*

<sup>85</sup> \$2.2 billion was committed by international community in 2005.

<sup>86</sup> Germany stopped new commitments of development aid (until the peace process advanced) and the UK suspended around \$3million of debt relief. The US's Millennium Challenge Account's commitment of \$110 million to Sri Lanka was put on hold in December 2007 'pending an improvement in the security situation'. Perhaps more significantly, several key multilateral donors such as the ADB and the World Bank reduced funding to Sri Lanka: total multilateral aid fell from \$502 million in 2006 to \$356 in 2007 (De Mel 2007).

<sup>87</sup> Total UK aid to Sri Lanka was £3.8 million in the 2007/8 financial year. In 2008 DFID pledged a total of £12.5 million in humanitarian assistance directed at internally displaced persons since October 2008 (Townsend 2009). Total assistance from the USA to Sri Lanka in 2009 was \$3.6 million (ERD 2009).

<sup>88</sup> In March 2010 the government decided that there would be not be a consolidated appeal. Instead it wanted funding to be channelled through the Presidential Task Force.

Regular country-wide development programmes are funded through a combination of ODA (grants and loans/credits) and commercial borrowing. Also, as already noted, the government's focus is on infrastructure development, particularly in rural areas, agriculture and small and medium industrial development, under the theme of poverty reduction and equitable growth (Kelegama and de Mel, 2007:10). A certain division of labour has emerged in the sense that economic infrastructure is funded by non-traditional donors or through commercial lending, whilst social infrastructure, governance, civil society and private sector development is funded through multilaterals and western bilaterals.

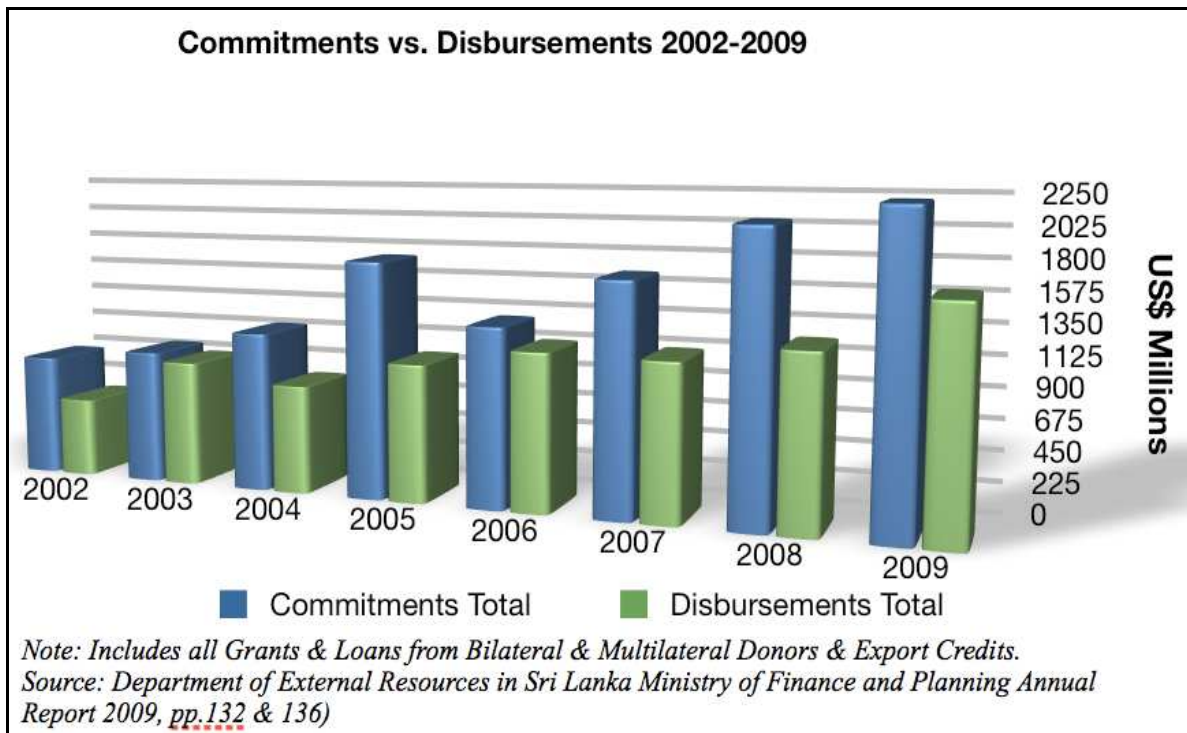


Figure 2: Commitments vs. Disbursements 2002-2009 (Department of External Resources 2009)

According to the Ministry of Finance Annual Report for 2009: the total commitment by donor agencies and lenders in 2009 reached its highest level of \$2,221.7 million, exceeding the 2008 total of \$2,069 million; loans amounted to \$1,942.1 and grants \$279.6 million; 75 percent of new commitments were for infrastructure development; the ADB, World Bank and China made up 86 percent of commitments; whilst some of the largest disbursements came from Japan 19.4 percent, China 18.5 percent, the World Bank 12.6 percent and the UN 7 percent; and bilateral donors accounted for 39 percent of disbursements and multilaterals 40 percent.

Foreign Aid Disbursement 2009

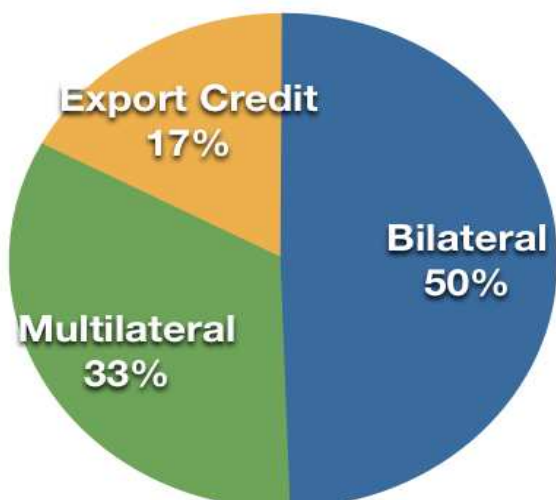


Figure 3: Foreign Aid Disbursements 2009 (Department of External Resources 2009)



Foreign Aid Disbursements 2009

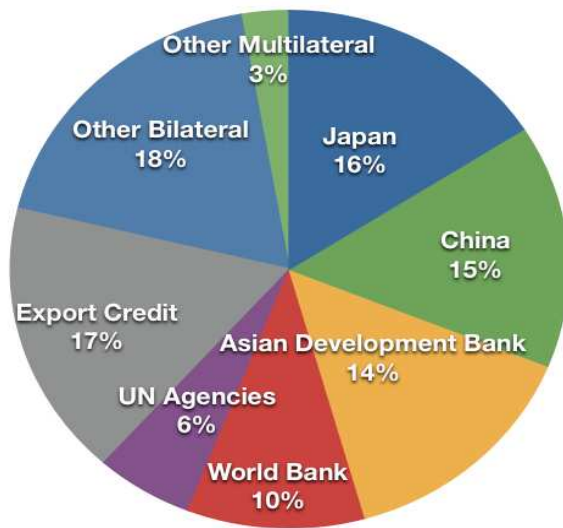
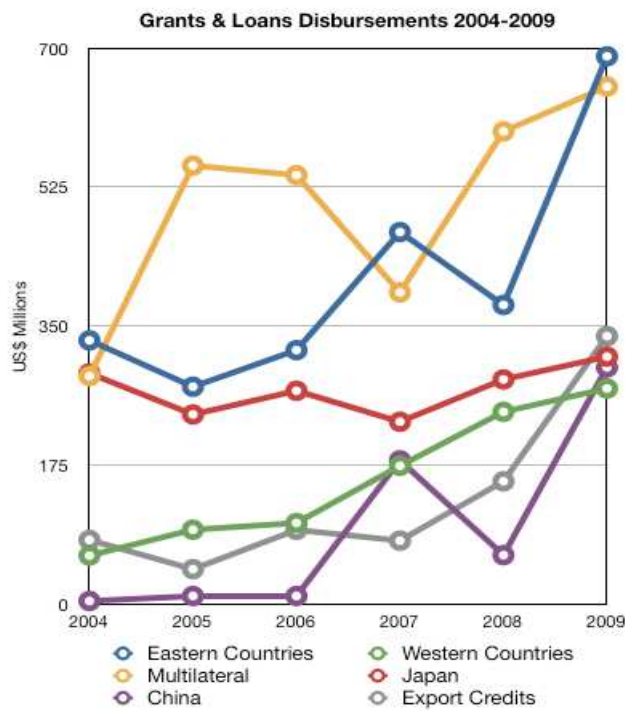


Figure 4: Grants and Loans Disbursements 2004-9 (Department of External Resources 2009)



Note: China & Japan are included in the 'Eastern Countries' data as well as depicted individually. Source: Government of Sri Lanka, Department of External Resources, Ministry of Finance Annual Reports (2008 & 2009 data from 2009 report, 2007 data from 2008 report, 2005 & 2006 data from 2007 report, Export Credit data from 2009 report... this is due to the fact that often data published is provisional for the just concluded year and revised/corrected for in subsequent reports.)

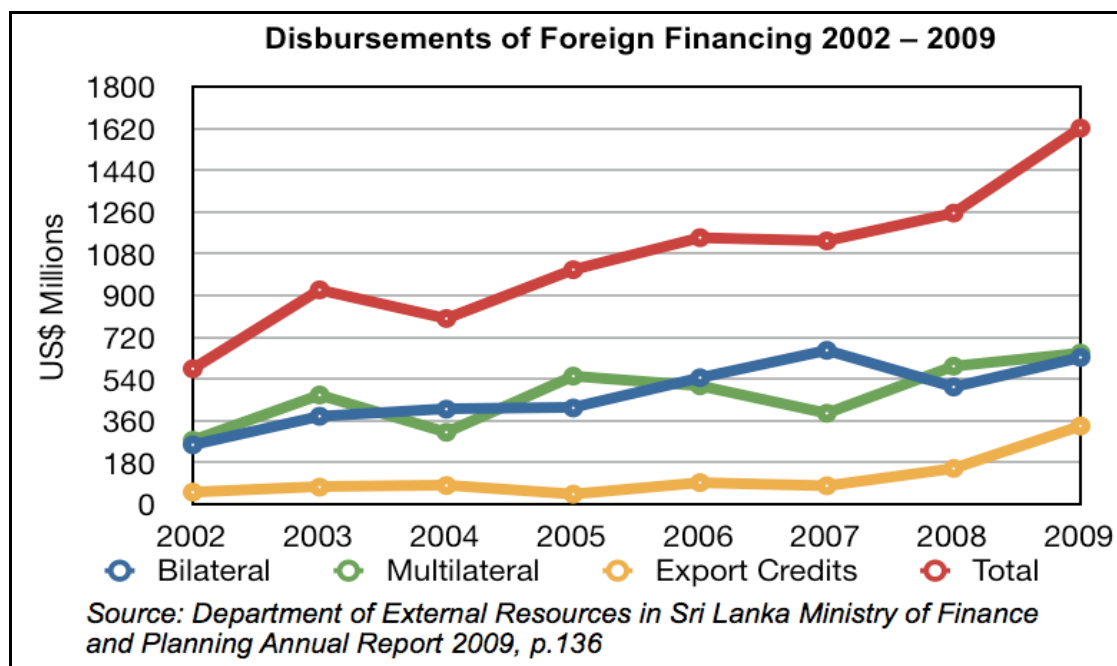


Figure 5: Disbursements of Foreign Financing 2002-2009 (Department of External Resources 2009)

### 3.5 Key Trends and Drivers of Engagement

A complex mixture of internal and external factors shape donor engagement in Sri Lanka and these have changed over time. These factors include: the influence of historical relationships<sup>89</sup>; changing conditions within the country including natural disasters, the dynamics of the conflict and graduation to middle income status; geostrategic and economic interests, with some donors making an explicit connection between aid and these issues whilst others attempt to delink them; aid frameworks including the Paris Declaration and the MDGs; domestic political issues and pressures in donor countries including the influence of diaspora communities<sup>90</sup> or concerns about migration,<sup>91</sup> and finally institutional mandates which influence the nature of the funding relationship and the activities supported.<sup>92</sup>

A number of key trends can be identified in the current donor landscape, which have been influenced by these different drivers of (dis)engagement:

First, as already highlighted, the increased importance of ‘non traditional’ donors (China, India, Pakistan, Korea, Iran). In particular, there has been an intensification and acceleration of China’s and India’s roles as donors and development actors in Sri Lanka, as each seeks to secure competing economic and geostrategic interests in the island. Indeed, this has produced a triangulation in which Sri Lanka has been playing these actors off the one against the other to secure maximum benefit in the form of power plants, sea ports, airports, railway links,

<sup>89</sup> Relatedly, the role of individual relationships should not be underestimated – for example former US Ambassador Lunstead (2007) noted that the personal interest and commitment of Richard Armitage was a key factor behind the shift in US policy towards the country during the peace process which involved active support of negotiations and increased aid funding.

<sup>90</sup> For example it helps to explain Canada’s preference to channel funds through executing agencies (NGOs and private sector) for the implementation of their development projects.

<sup>91</sup> For example this has been a significant push factor driving increased levels of Australian funding to the country in addition to a global commitment to increasing funding so as to reach .7% of GDP.

<sup>92</sup> The IMF for instance, has a very distinct mandate that focuses on macroeconomic issues and cannot stray into political issues. Similar political restrictions are placed on the World Bank.

housing and roads (Lewis 2010). Further details about China's and India's roles as aid donors are provided in Boxes 1 and 2:

### **Box 1: The Rise of China as an Aid Donor**

China does not distinguish between ODA from economic cooperation or investment and therefore there is a blurring of concessional finance with other financial flows. However, China was the largest source of foreign funding in 2009 providing \$1.2 billion, almost triple the amount given by the ADB.<sup>93</sup>

Like Japanese aid it focuses primarily on infrastructure and agriculture without being tied up with a package of political or economic reforms. The so-called Beijing policy consensus combines a number of elements including a focus on: capital accumulation; economic nationalism; large scale infrastructure; government capabilities and centralization; rural industrialization and manufacturing; no interference in policy making. The Chinese tend not to relate to other donor forums and coordination mechanisms, doing all their business bilaterally, with Chinese embassies being 'crucial nodes' in negotiations with recipient countries (ibid).

The complex direct and indirect effects of Chinese trade, investment and aid are not yet fully understood. Mainstream writing on Chinese aid has tended to be critical regarding its links to authoritarianism in Africa. Alternatively, it has been argued that the emergence of China represents a golden opportunity for Africa, an alternative to Washington and thus an opportunity to practice 'fiscal triangulation'.

For the first time since the end of the Cold War, African countries have some choices about aid and investment' (Tan-Mullins et al, 2010: 865). In the case of Sri Lanka, the growth of Chinese funding coincided with a critical pressure point in the life of the administration and provided them with the policy space needed to finish off the war and pursue a strategy of securitized development.

### **Box 2: India's economic role: donor or neighbour?**

India's post-war infrastructure investment in Sri Lanka includes the reconstruction or upgrading of Kankasanturai port, and Palali airport in the Jaffna peninsula, railway reconstruction in the Mannar – Talaimannar and Omanthai – Kankesanthurai sectors (also in the north). While the location of these projects in the north reflects a concern to target aid towards the war-affected Tamil north, it also reflects a desire to orient aid towards the expensive 'hardware' and infrastructure that will be most useful in gaining influence with the Sri Lankan government, and is also a desire to parallel and match the sizeable amounts of Chinese investment in infrastructure in the south.

In humanitarian relief and early reconstruction, India's headline aid programme is a \$300 million grant for the reconstruction of 50,000 housing units, primarily in the Vanni. In addition, there has been a significant amount of emergency aid, shelter material, and family packs, mostly in 2009. This element of India's aid package is clearly calibrated to respond to the deep wellsprings of discontent among Tamils in both Sri Lanka and India, over India's role in the last stages of the war.

There is a fairly clear understanding within India's foreign policy establishment that foreign aid is essentially the currency required to buy diplomatic influence in the region and beyond, to support India's commercial interests, and to achieve some of the key foreign policy goals, including permanent membership of the UN Security Council.

<sup>93</sup> Leahy, J V, 2010 'Beijing tightens its embrace of Sri Lanka, Business English

Unlike other emerging donors such as South Korea, who have increasingly conformed to the language, modalities and metrics of more traditional DAC donors, and have sought to be part of DAC, India has consciously styled itself in a different manner, and does not want its assistance to be labelled as aid. As the Indian High Commissioner, Ashok Kantha described ‘We are not a donor. We are a neighbour’. India’s aid to Sri Lanka, as with Afghanistan, Bhutan, Nepal, and newer recipients such as Myanmar and Laos have significant domestic and regional security compulsions in mind, as well as commercial ambitions. But Sri Lanka is unique in the Indian aid programme, and differs from all these other countries in that it contains a strong domestic electoral component. Since the end of the war, political leaders from Tamil Nadu have faced heavy pressure from their own base to ‘do more’ for their Sri Lankan Tamils cousins.

Second, the government has asserted ‘ownership’ over its development agenda, which in the north and east has involved a highly securitized, not to say militarized kind of development. The military defeat of the LTTE, as discussed earlier, has transformed the governance and aid landscape. It has meant the end of a bifurcated aid system in which largely humanitarian assistance delivered through NGOs went to the north and east, whilst ‘normal’ development aid, through the government channels went to the south. Now the government has reasserted control over its ‘unruly periphery’, it has sought to incorporate or bring an end to the parallel, semi autonomous aid delivery systems that emerged in wartime. Development activities are tightly controlled and monitored and ‘software’ aid programming (frequently pursued by the smaller donors) in the form of, for example, human rights, gender, governance and rule of law issues are significantly reduced if not banished. Therefore the central hub of the government, namely those apparatuses controlled by the Rajapaksa brothers (e.g. the Ministries of Defence, Economic Planning and the Presidential Task Force) have increasingly vetted, approved and overseen the passage of development and humanitarian programming in the island, filtering out programmes or elements that are seen to contain unwanted ‘software’.<sup>94</sup> This tendency has also been accompanied by a stricter visa regime for foreign development and humanitarian personnel with a number of cases where visas have been withheld, revoked and/or INGO staff have been expelled.<sup>95</sup>

Third, as a result of the above, ‘humanitarian space’ has been severely constrained. The government is deeply suspicious of agencies that have had a long presence in the north and east, particularly in formerly uncleared areas. They are suspected of being ‘pro-LTTE’ and therefore ‘pro-terrorist’. It is also feared that they may have information about war time violations that may be used against them in the future. Access has been strictly controlled and there has been a radical ‘thinning out’ of the humanitarian community in the north and east. ICRC and UNHRC offices have been closed and the decline of an on-the-ground presence has important implications for protection issues.

Fourth, with the much reduced role of ‘likeminded’ donors (see below), there has been a decline in funding for the more ‘political’ and sensitive sectors including governance, civil society, peacebuilding and human rights. State reform is not on the agenda, with economic growth having been delinked from the promotion of liberal democracy. The government agenda now is largely about growth with nationalism.

Therefore, there has been a decisive shift away from the peace activism of the 2002-2005 period, with the pendulum swinging back to earlier forms of behaviour and funding characteristic of the late 1990s, when donors essentially worked ‘around’ conflict (Goodhand, 2001). Words like ‘peace’ and ‘reconciliation’ have become taboo. Donors have become more risk-averse in their behaviour. There has been a return to basics in the sense of focusing on a narrow, technical development mandate.

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<sup>94</sup> Interviews, donor officials, Colombo, July 2010.

<sup>95</sup> For example, in July and August 2010 four Non Violent Peace Force staff had their visas revoked.

Fifth, the aid landscape is characterized by greater diversity, not to say fragmentation compared to 2005.<sup>96</sup> This is partly related to the competitive pressures that have come about with the growth of ‘non-traditional’ donors and the government’s ability to deploy fiscal triangulation or ‘donor shopping’. Coordination mechanisms and attempts to make aid coherent and integrated have been weakened, gone into hibernation or been replaced by more informal structures. The OECD/DAC peacebuilding evaluation of 2009 noted that ‘donors’ strategies became increasingly unaligned and unharmonized’ (p20). This mirrors in some respects the wider breakdown of OECD policy consensus. Joined-up approaches have become more difficult with the rise of new donors who do not participate in regular coordination mechanisms and prefer to act bilaterally rather than multilaterally. Donors have also found coordination with the government difficult because of the rising number of ministries (OECD/DAC study, 2009) and dual power structures – for example NGOs now have to register with the Ministry of Defence and humanitarian agencies with the PTF.<sup>97</sup>

However, the principal driver of aid fragmentation has been the divide-and-rule strategy of the government, which does not want to deal with autonomous and powerful collectivities of donors. It wants to avoid a donor cartel which reduces choices and negotiating leverage (Keligamar and de Mel, 2007). The GoSL consciously played on aid workers’ fears of being ‘PNG’ed.<sup>98</sup> Informants talked about how a ‘culture of fear’ and a ‘criminalisation of coordination’ had tangible effects on aid staffs’ behaviour. Expatriates were scared of ‘getting hammered publicly’ and according to one informant ‘they were shell-shocked when they came out of meetings with Gothabaya’. This led to self censorship, and increasingly informalised approaches to coordination – such as the INGO heads ‘coffee club’ meetings, which perversely accentuated local fears of foreigners conspiring behind the backs of the government.

### 3.6 Taxonomy of Donors

A taxonomy commonly used by donors themselves is the distinction between the ‘likeminded’, ‘partially likeminded’ and ‘un-likeminded’<sup>99</sup> – in practice it is more complex than this and there is a spectrum of approaches, characterized by differing motivations, goals and modalities. Each group’s approach is underpinned by differing implicit or explicit theories of change.

#### *Likeminded:*

The underlying assumption is that aid may be a lever for political change including state reform, conflict resolution, democratization, human rights promotion. The ‘likeminded’ have an image of themselves as being enlightened and progressive donors. Aid is de-linked from geostrategic or partisan interests, and these donors tend to be strong supporters of International Humanitarian Law (IHL) and International Human Rights Law (IHRL), and of the Paris Declaration principles – although the tensions between these frameworks has been exposed by the impossibility of simultaneously promoting rights alongside a commitment to government

<sup>96</sup> Examples of coordination bodies and groupings for development activities include; Donor partners meeting – monthly review of the situation chaired by the World Bank, ADB, UN + 1 bilateral; Bilateral Donor Group (BDG) chaired by EU delegation and Switzerland, which has several working groups – Human Rights (EU and UN office of HR); Mine action (UNDP/USAID); DDR (USAID); civil society; diaspora; police; Donor Peace Support Group; INGO heads ‘coffee club’. Examples of coordination bodies and groupings for humanitarian action include: Coordination Committee for Humanitarian Assistance (CCHA) Chaired by GoSL; Inter-Agency Standing Committee (Humanitarian/UN and NGOs); UN cluster meetings; Post-tsunami donor groups; ICRC/IFRC networks; CHA (although some informants felt that its independence and legitimacy as a credible representative organization has declined).

<sup>97</sup> The government information ministry stated on Nov 10, 2010 that some 250 international and 1000 domestic aid agencies needed to obtain approval with the defence ministry following a change in the law. It added that the ministry will also process foreign aid workers’ visa applications which must be made through the newly established National Secretariat for NGOs. (Amal Jayasinghe AFP ‘Sri Lanka tightens grip on foreign aid workers’)

<sup>98</sup> This has reportedly been used to good effect to intimidate senior UN officials with families in Colombo.

<sup>99</sup> It should be noted that this categorization was primarily developed by the ‘likeminded’ donors and the taxonomy is based upon some problematic assumptions – for example the ‘unlikeminded’ categorization can be read as a short hand for ‘unlike us’, and in many respects this group have greater cohesion in terms of values and approach than the ‘likeminded’.

'ownership' and 'partnership'. Also there are tensions related to the fact that many of these donors have been simultaneously providing humanitarian aid to the north, whilst continuing with development programmes in the south, each involving differing challenges related to principles of engagement and access. During the CFA period a group of likeminded 'activist' donors were extremely influential though the donor peace support group in mobilizing the wider donor community to support the peace process. Ultimately, as already noted, this induced a reaction from nationalists and confirmed old prejudices that donors were supporters of the UNP and elitist, Colombo-based civil society. This group has been most singled out for the attacks by nationalists. They are also becoming increasingly marginal as funders, both in absolute terms – with Sri Lanka's graduation to middle-income status and the end of the war<sup>100</sup> the rationale for engagement has declined – and in relative terms with the emergence of non-traditional or 'unlikeminded donors. Norway for instance is seeking to 'normalize' its bilateral relationship with Sri Lanka, which has involved reducing an aid programme that expanded during the peace process. Some are withdrawing altogether, DFID for example stopped its programme in 2004. Those who remain with very limited activities have become less funders than advocates, small and increasingly marginal critics of the government on issues related to human rights, humanitarian needs and reconciliation. As one of interviewees from this group of donors commented, 'we want to be here more than they (the government) want us to be here'. More pragmatically inclined donors criticize them for taking too dogmatic a position: 'Donors are still too simplistically trying to identify the good guys and bad guys'<sup>101</sup> Arguably they are more able to play this role because they have less to lose politically and financially than larger donors.

#### *Partially likeminded:*

This group has much stronger incentives to engage with the government as they have relatively large aid programmes. They are very much part of the Washington/post-Washington consensus and have signed up to the associated frameworks of 'good donorship' and aid effectiveness. The Paris Declaration and notions of ownership legitimize the building of close relationships with the government. However, their aid is ostensibly less political with its focus on economic growth, poverty and social protection. The multilaterals have mandates which explicitly prevent them from engaging in internal political matters. The bilaterals however do tend to link their aid to other commercial or security interests – for example the links between Australia's aid programme and concerns about migration. Sometimes there may be tensions between aid goals and other sets of interests – for example the US has to manage competing sets of interests related to foreign policy, human rights, military aid and development aid. Such donors have large programmes and strong disbursement pressures, leading to the prioritization of access over advocacy: 'Delivering to scale means that you have to work with the government and be shaped by their preferences'.<sup>102</sup> They take the pragmatic view that delivering material assistance should be prioritized, in the short-to-medium term rather than vague and long-term goals related to political transformation. They are not unaware of conflict issues, for example the World Bank employs a 'conflict filter'.<sup>103</sup> And their approach appears to be based on the underlying assumption that development assistance can help deliver a 'peace dividend' and thus stabilize the peace. They believe in engaging with the government, which is not monolithic and there may be sectors and areas in which donor agendas and the government's may coincide. Japan in some respects spans the 'partially-likeminded' and 'un-likeminded' categories. Whilst being a strong supporter of the peace process, it has been reluctant to push on human rights (it abstained from the vote at the UNHRC in May 2009). As has been the case in other countries Japan takes a pragmatic line by seeking to establish common ground with recipient governments and avoiding areas of non-agreement (Arase, 1995). In some respects as already noted there are commonalities between its approach and China's.

#### *Un-likeminded:*

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<sup>100</sup> For some donors the conflict was one of primary reasons for the continuation of bilateral aid in a country that would otherwise no longer qualify for assistance.

<sup>101</sup> Interview with aid donor advisor, Colombo, September 2010.

<sup>102</sup> Interview with bilateral aid donor, Colombo, July 2010.

<sup>103</sup> The filter asks: Has sufficiently broad stakeholder consultation been conducted? Have adequate impartial grievance mechanisms been established? Are project management and administration adequately sensitive to inter-ethnic issues? Are conflict-generated needs adequately identified? Have opportunities to strengthen reconciliation and inter-ethnic trust been adequately identified?

Whilst there are differences, a common underlying assumption for these countries appears to be that aid can play a role in promoting economic transformation and growth as well as cementing diplomatic relations. Furthermore the boundaries between aid, trade and foreign policy are blurred. This group does not explicitly link their aid to political conditionalities and they tend to work outside western donor circles. Both China and India tie their aid to commercial concerns, including labour, consultancy and sourcing. For example, Indian lines of credit are linked to Indian companies and products. There is a lack of competitive bidding unlike multilateral aid and so though interest rates may be low, expenses can be high. Also, there is a lack of transparency which leaves room for corruption.

### 3.7 Sovereignty Bargains: unpacking engagement, influence and ownership

As Alex de Waal (2009) notes, international actors enter the domestic ‘political marketplace’, not as neutral referees, but as players who become enmeshed in and help shape (and are themselves shaped by) this marketplace. As outlined above the nature of this marketplace and its different players have changed markedly since 2005, something that western donors were perhaps slow to recognize and understand. In the context of an increasingly centralized, patronage based political system, and a counter-reforming state that is decreasingly dependent on western finance, the opportunities to find common ground with, let alone influence government policy have diminished. In most aid contexts donors and recipients engage in anticipatory bargaining, in which they habitually manoeuvre around one other to find mutually acceptable approaches, anticipating each other’s positions and adapting accordingly. However in Sri Lanka, negotiating capital and bargaining power has shifted decisively in the Government’s favour. Whilst wider debates on aid and conditionality tend to assume the agenda setting power of donors and the limited room for manoeuvre of recipient governments, in Sri Lanka it is now the opposite situation. Ownership, which is about control over the policy agenda – rather than rhetorical commitments to neo-liberal policies –, has been confidently asserted by the regime. Because of its ability to triangulate between funders, the government is now to some extent in a position to place conditionalities on donors, forcing them to align behind its particular model of development. For example, the Ministry of Economic Development explicitly states that they will ‘align donor support behind the GoSL’s development strategy and aid policy’. In P. B. Jayasundara, Secretary to the Treasury, they have an extremely forceful advocate who has played an important role in enforcing donor ‘harmonization’.<sup>104</sup> As one interviewee noted: ‘I’ve worked in a few countries and this is definitely the hardest..... there’s no money and no leverage to do things right’.<sup>105</sup> Government officials, and particularly the military, in the north and east are very much in the driving seat.

The government strategy has exposed tensions and divisions within the aid community, particularly between the likeminded and partially likedminded about how and whether to engage. Unsurprisingly these issues became most polarized in relation to international intervention in the north and east. There is a perception amongst aid agencies that humanitarian space was constantly conceded to the government, first in the east and then the north.

In a recent report for WFP entitled ‘Compromise or Capitulation?’ David Keen examines government strategies to control aid delivery and humanitarian actors’ responses. Keen argues that aid agencies’ responses were based upon a flawed ‘natural disaster model’ which prioritized delivery and was largely blind to underlying political dynamics.

Keen concludes that ‘to a very large extent the government has dictated terms to the international community when it comes to humanitarian aid and protection issues’ (p. 56). It should be noted that the bargaining position of aid agencies was weak from the beginning, because of the hostile atmosphere and well articulated critique of

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<sup>104</sup> There are some parallels here with Ashraf Ghani, the Afghan Finance Minister, 2002-2004, who was a former World Bank official, and who very skillfully set the development agenda in Afghanistan and forced the donor community to follow the government lead. This quickly changed after he was replaced in a government reshuffle.

<sup>105</sup> Interview, aid official, Colombo, July 2010.

humanitarianism from the government and local media. And the government was able to exploit these legitimacy deficits, playing upon public cynicism about the motivations and attitudes of international actors.<sup>106</sup>

US criticism was dismissed by the Sri Lankan authorities as ‘no carrots and all sticks’ (US Senate Report, 2009:2), and was regarded in Colombo as heavy handed and shrill (ibid: 15). This point is reinforced by a long-term aid worker in Colombo, who critically reflected upon how international actors interacted with the government:

‘The process of engagement is poorly understood in the donor community....engagement doesn’t necessarily mean endorsement. Negotiation skills are very weak and cultural issues poorly understood....three or four of the usual suspects get together and draft a letter ... they communicate every time there’s a problem. This is not the fundamental principles of aid effectiveness and partnership....there’s a vicious circle of over-reacting.’<sup>107</sup>

A perhaps under-recognised aspect of the western donor-government interaction is its cross-cultural dimension, which can be related to the changing nature of the ruling elite, as noted in Section One. According to one analyst ‘donors understood the social cues and rationality of the old elite, but they are confused by the current administration’. The same interviewee went on to argue that given the expansion of political circles beyond the confines of Colombo 7 and the associated ‘vernacularization’ of the elite, donors needed to develop a better understanding of nationalist sensibilities and how they influenced behaviour and policy.

The war for peace created an important legacy in terms of government-donor relations. The government learnt several lessons including: western pressure could be withstood, if not ignored, and non western allies and donors could provide diplomatic cover and help fill funding gaps; that western actors could be intimidated into silence or played off one another; when the international agencies did speak with one voice or adopted common approaches – such as UNHCR guiding principles for engaging in the welfare camps – these were never stuck to consistently; restricting information and dealing with aid agencies bilaterally permanently kept them on the back foot; that donors could be made to meet the government’s own ‘compliance’ requirements<sup>108</sup>; aid organizations with programmes in the south and the north may be more vulnerable to pressure to compromise on principles so as to maintain their in-country presence; finally on occasion there has been a time lag between changes on the ground and strategic adjustments in donor policies – they were sometimes behind the curve and trying to catch up with events.<sup>109</sup> Therefore the government has prioritized its relationships with non western players or the ‘unlikeminded’, whose interests and ways of working appear to be more in tune with the current regime.

### 3.8 Aid, Conflict and the State

Research on Sri Lanka and elsewhere highlights the complex pathways and relationships (direct and indirect, intended and unintended) connecting foreign aid to conflict/peacebuilding dynamics (cf. Herring, 2001; Uvin, 1998; Moore, 1990; Goodhand, 2006; Venugopal, 2009). The idea that development may represent a short cut to security is an old one in Sri Lanka. There are some distinct similarities between the Jayawardene regime and the current government in terms of the development-conflict nexus. Both leaders radically centralized power, deploying a combination of patronage, coercion and constitutional change to do so. On the economic front both combined economic liberalization, with populist large scale development projects – in Jayawardene’s case, largely funded through unconditional western multilaterals and bilaterals, whilst in Rajapaksa’s case through non-western bilateral donors and commercial loans.

<sup>106</sup> For example in his evidence to the LLRC Rajiva Wijesinghe stated that ‘After all, though most people working in this field have ideals we should respect, their first allegiances are to their own careers, the institutions for which they work, and the countries they come from, rather than Sri Lanka and its people.’

<sup>107</sup> Interview with aid donor advisor, Colombo, September 2010.

<sup>108</sup> A recent, though perhaps unenforceable example is the requirement that local MPs should be present at any aid distribution in the north.

<sup>109</sup> This is a point also made by Lunstead (2007) in his analysis of US engagement during the peace process.



Similar aid-conflict patterns and connections can be identified. Although the links between post 1977 liberalization and conflict dynamics were complex and contested, it is clear that economic liberalization and large infrastructural projects had significant distributional effects, heightening actual or perceived intra and inter-group disparities – leading to grievances that were channelled into ethnic scapegoating (Herring, 2001). The current regime has not departed in any significant way from the economic framework set by the UNP regime and followed by successive governments. Opening up the north and east to the forces of capitalism will have profound and contradictory effects, with the potential for those on the periphery, namely Tamils and Muslims to be economically as well as politically disenfranchised (cf Bastian, 2010; ICG, 2008, 2009). Interviews in Jaffna and the East revealed concerns that these processes have already been set in train, with for instance the buying up of prime land for tourist developments and Sinhalese contractors winning major bids to deliver foreign funded infrastructure and development projects.

A second possible conflict inducing effect of foreign aid, which again parallels the Jayawardene regime, is the investment in large-scale infrastructure projects. Apart from the well-documented effects on the ethnic geography of the periphery, this influx of new money changed the nature of political competition at the centre, by increasing the stakes and therefore the intensity of the battles to gain and stay in power. The Jayawardene period was associated with the expansion and intensification of patronage-based, spoils politics, which, as argued in Section One, has been given a new lease of life today. Herring's (2001) analysis that the large 'carrots' of aid, were as harmful, in conflict terms, as the 'sticks' of structural adjustment conditionalities is particularly pertinent today. The changed composition of foreign aid may accentuate this trend – western donors are arguably more demanding on accountability and corruption issues than 'non-traditional' donors. Also the relative decline of donor support in the areas of governance, rights and civil society may also contribute to the erosion of institutional and societal checks and balances on the regime. Finally, there is also the question of aid fungibility – just as Jayawardene utilized foreign funding to strengthen the security apparatus of the state, Rajapaksa has been able to maintain and even increase the size of the security forces, partly as a result of the financial cushion provided by foreign aid.

Apart from its material effects, foreign aid has had and continues to have significant symbolic and discursive effects. Internationally supported projects have been closely tied to a nationalist discourse of the state as the provider and protector of the Sinhala peasantry, something that is very apparent in *Mahinda Chintana*. Secondly, and in apparent contradiction to the above, the scapegoating of western donors and NGOs (and their proxies within Sri Lankan civil society) is central to the reproduction of Sinhala nationalism. With the fall of the LTTE, the principal threat that sustained Sinhala nationalism in the recent historical past appears to have been defeated in the domestic sphere. The increased antagonism towards international actors may partly be related to the urgent need to build in-group coherence by externalizing threats. Thirdly, international actors are leveraged by the political opposition – and in many respects have become a substitute for the opposition – in order to put pressure on the regime. The instrumentalisation of the war crimes issues is an example of this.

The above points need to be considered in the light of western donor efforts to address, directly or indirectly, conflict issues. They have tended to focus on five areas of concern, each linked to different implicit or explicit understandings of conflict and 'post conflict' peacebuilding: (i) human rights and accountability; (ii) reconciliation and social integration; (iii) governance, democracy and the political settlement; (iv) development and reconstruction; (v) conflict sensitivity. Each are briefly addressed below.

(i) *Human rights violations and accountability*

The question of human rights, war crimes and accountability is the most contentious issue. A diverse group of actors and organizations actively support, or are sympathetic to, the view that justice, truth-telling and accountability are a precondition for long-term peace – and are therefore lobbying for, or tacitly supporting the search for a mechanism that allows this to happen in a credible and independent way. Supporters of this position include the Tamil Diaspora, members of the international human rights and advocacy community such as Amnesty International, ICG, Human Rights Watch, elements of the UN, the EU and its member states, parts of the American administration and several smaller bilateral donors. On the opposing side Sri Lanka has powerful allies including China and Russia who would veto UN proposals for a war crimes tribunal. India is more

ambivalent and at times has intimated that it would not oppose such an initiative. The sensitivity of the Rajapaksa regime to this question is evident. The formation of the LLRC was one indication of this. Many interviewees felt that the paranoia that this issue generates helps to explain the brothers' ruthless centralization of power and their policy of 'aggressive defence' in relation to the international community.

Broadly two very different positions emerged from interviews related to this issue. On the one hand, a number of people felt that war crimes were the only source of leverage on the government and pressure must be maintained. It was reasoned that some kind of reckoning must take place in order for there to be a genuine reconciliation and a long-term political settlement. Some interviewees took a more pragmatic line, believing that war crimes could be used as a point of leverage to encourage substantive devolution. This issue also has significance beyond Sri Lanka, since a number of countries find the 'Sri Lankan model' of counter-insurgency and securitized development a more attractive proposition than trying to negotiate with 'terrorists'. An internationally supported process to address war crimes and justice would send out a clear message that governments cannot act with impunity and must be held accountable according to IHL and IHRL.

On the other hand, there is a view that pressure on the government paradoxically plays a role in boosting its legitimacy. Just as external involvement in questions of political reform provokes nationalist resistance, the same applies to human rights issues. This is a regime which has deep existential concerns about security and the war crimes issue feeds its paranoia, leading to more repressive policies internally and confrontational approaches externally. It provides a further opportunity for the government to present the West as imperial and neo-colonial and that human rights are another instrument of western hegemony, which are applied inconsistently and hypocritically. Furthermore, some aid actors working in the north and east felt that accountability for rights violations was not a priority of people on the ground at this moment – they were more concerned about basic survival and livelihood needs and this should be the focus of western support: 'they [donors] should not get trapped in rhetoric so it prevents them from being able to work with the people. They must prioritize the vulnerable today rather than standing firm over getting justice for the dead.'<sup>110</sup>

Both positions have their own validity and logic and can perhaps be pursued on parallel tracks. Aside from the question of war-time violations, several donors continue to fund activities with an explicit focus on human rights and accountability, largely through civil society organizations.

#### *(ii) Reconciliation and social integration*

A second and related area of concern for western donors is that of 'reconciliation' and 'social integration'. Whilst war crimes and rights issues are conventionally seen as being backward looking and redistributive, reconciliation and 'forgiveness' are seen as being forward-looking and restorative. Evidently there is more official support, rhetorically at least, for reconciliation since it is less politically loaded and is sufficiently vague to carry many different meanings. Often it is used in the context of improving inter-community relations and 'civic participation' – building bridges and relationships between Tamils and Sinhalese, though such an approach is severely limited in its conceptualization of the conflict as being between Sinhalese and Tamils and ignoring the question of state power and politics. Social integration is a similarly slippery term particularly given the government's denial of space to plural identities - Mahinda Rajapaksa having famously asserted that there are 'no minorities' in Sri Lanka. However, several donors including Canada and Germany have reframed their programmes so as to address more explicitly questions of social integration. Canada for example works with the Ministry of National Languages and Social Integration on issues to do with language and education for social cohesion. Germany has integrated social cohesion and transformation into its FLICT programme. There is clearly some overlap in this area between the agendas of the government and aid agencies. For instance Rajiva Wijesinha when giving evidence to the LLRC highlighted the importance of education as channel for integration and, reviving an old debate, the potential for English as a link language. However, despite the continuing and widely recognised significance of English as a vehicle for social mobility, both international and government programmes seem to have had limited effects, As a result this is an area for further engagement.

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<sup>110</sup> Interview with a Sri Lankan aid worker, Colombo, August 2010.

*(iii) Governance, democracy and a political settlement*

Third, there is perhaps least scope to work on questions of governance and state reform which touches at the heart of the conflict and is consequently the most politically sensitive. With a few exceptions e.g. the One Text initiative which aims to create the conditions to bring together political actors to forge a new more inclusive settlement, most programmes touch on these questions of state power and reform obliquely, aiming to work through drivers of change at the local level or in the diaspora. As already outlined in section one, the direction of change has been in the opposite direction, towards a more exclusive, majoritarian and centralized political settlement. Some donors have been working with the Tamil diaspora and several NGOs and bilateral donors with significant diaspora populations are engaging in dialogue on this issue.

Finally, at a more modest level, local governance is seen as an entry point and catalyst for democratization of politics at the local level. A number of donors and aid agencies have thus attempted to reorient their work to the local level (cf. Walton, 2008), focusing on local government, service delivery, social accountability and CBOs such as rural development societies and cooperatives. But the government influence is pervasive and there are few spaces and organizations that have not been penetrated and politicized – much in the same way as the LTTE co-opted local structures and institutions.

*(iv) Development and Reconstruction*

Fourth, donors provide support in the north and east based on the assumption that this will create a peace dividend, whilst addressing some of the economic grievances that catalyzed conflict in the first place and if unaddressed could lead to its reoccurrence. USAID, for example, states that its strategy in the East 'is based on the premise that economic growth can contribute to building social and economic security, which in turn can help establish conditions conducive to a sustainable political solution'.<sup>111</sup> To some extent there has been a growing alignment between Sri Lanka's nationalist-oriented developmental thrust and the actions of some of the medium to large sized donors. To cite one example of this alignment, at least two donors in interviews suggested that it was entirely commonsensical to think that "mono-ethnic areas" must be a thing of the past and eradicated and that development efforts which resulted in a demographic reordering of the north and east would promote ethnic mixing and therefore peace in the long term rather than serve as a future dynamic for conflict as has been the case in the past.<sup>112</sup> Another area of support by donors has been the reintegration of underage ex-combatants, but no donors have provided support for the government 'rehabilitation' camps in spite of government appeals.

*(v) Conflict Sensitivity*

Fifth, 'conflict sensitivity' is a cross cutting issue that most donors at least refer to in their planning documents and strategies. Many donors routinely employ conflict advisers along with 'conflict sensitivity' tools and frameworks. However, their engagement in the north and east appears to be based on the assumption that reconstruction and the economic development of the region will necessarily ameliorate long-standing ethnic grievances (Goodhand, 2010). No formal peace conditionalities (cf. Boyce, 2002) have been applied to reconstruction funding, though admittedly the track record of such conditionalities in the Sri Lankan context has been poor (Goodhand and Klem 2005; Frerks and Klem 2006). USAID and the World Bank drafted an informal set of principles for their work in the east: the rapid return of civilian rule; protection of human rights; demobilisation of paramilitaries; and no support for demographic changes. However these conditions were not made public and there were no procedures for monitoring and compliance (ICG, 2009, p. 10). Furthermore, even if donors apply conflict-sensitive principles to individual projects, this does not prevent them from having perverse effects on conflict dynamics at a macro-level (Goodhand, 2010). 'What does it mean to be conflict sensitive at the micro level when you are supporting non conflict sensitive government policies by freeing up new government money' (aid donor cited in ICG, 2009, p. 9).

<sup>111</sup> Cohen, R (2009) 'The Role of and Support of Other Key Development Partners in Sri Lanka's Development' Speech delivered at the EU Sri Lanka's Business Summit, 2009, 5-6 May.

<sup>112</sup> Interviews, aid agency officials, Colombo July 2010.

In conclusion, whilst conflict is of sufficient importance to be put in most country strategy papers, its inclusion has been largely cosmetic. Apart from the human rights/accountability question, there has been a drift amongst western donors away from politically sensitive areas (which they increasingly engaged in during the peace process). Aid donors who wish to remain operational and engaged in a significant way have recalibrated their programmes first to minimize political risks and second to minimize conflict risks. At best this ensures they do no harm, at worst, they risk reinforcing a government programme of securitized development. The partially likeminded and unlikeminded have strong disbursement pressures and thus prioritize their relationship with government. Pushing on the human rights issue may impede work on other fronts and thus remains a priority only for a small group of the 'likeminded' who have become more advocates than donors. And across the board aid effectiveness is impeded by a lack of data and evidence, linked to limited access, and patchy coordination, related to a conscious government strategy of divide and rule.

## SECTION FOUR: DRIVERS OF CHANGE

### 4.1 Overview

The first three sections of this report map out the political, economic, international landscape upon which the policy environment and context in contemporary post-war Sri Lanka are based. This section on the 'drivers of change', elaborates on the dynamic elements within and between the political and economic spheres that are likely to influence changes to this internal landscape over the next six years of the life of the present legislature and executive presidency.

One of the most remarkable features of the first Rajapaksa government of 2005-10 was the extent to which it managed to preserve the stability of its core policy agenda in the face of a variety of domestic and international factors and pressures, and as such, to contain and limit some of the most important drivers for change to its advantage. This was not an insignificant achievement, considering that Sri Lanka is a small, trade-dependent country with a PR-based electoral system that had hitherto produced weak and unstable coalition governments. Between November 2005 and May 2009, the government succeeded in its single-minded pursuit of winning an outright military solution to the conflict, and did so despite suffering from weak parliamentary arithmetic, a fluid coalition of unstable and mercurial allies, a spiralling economic crisis, and considerable international pressure.

Since then, the government's ability to respond to and manage sources of political instability has been strengthened manifold, due primarily to two factors: (i) the end of the war and the elimination of the LTTE; (ii) the significant increase in the legislative and executive powers of the government. As the experience of legislating the controversial 18<sup>th</sup> Amendment to the Constitution in September 2010 demonstrates, the Rajapaksa government has the skill, capacity and determination to carry forth an ambitious and controversial agenda, to co-opt or neutralise a wide variety of domestic constituencies in doing so, and to resist, anticipate and defuse domestic and international dynamics to its advantage.

- (i) The Impact of the End of the War on Drivers of Change: The end of the war, and the elimination of the LTTE as a political-military threat to the state, has effectively removed what was hitherto the most important and unpredictable driver of change in Sri Lanka. For over three decades, the LTTE's presence as a resilient and highly motivated insurgent organization with a maximalist-separatist agenda, control over significant parts of the Tamil population in the north and east, a reputation for military ingenuity, a track record of striking high-value targets, and a willingness to inflict high numbers of civilian deaths, was the biggest source of political uncertainty in the country.

As the Sri Lankan state became increasingly embroiled and preoccupied in prosecuting the civil war through the 1980s and 1990s, the parallel, dialectical processes of war-making and peace-making came to shape and influence the nature of the state and the exercise of state power in myriad ways. More importantly, the nature of war termination has left a strong imprint on the post-war period, and on the way that the state relates to minorities and marginalised groups.

The elimination of the LTTE has effectively removed what has hitherto been the biggest incentive for successive Sri Lankan governments to engage in political negotiation on the ethnic conflict. While the LTTE was in existence, there were a series of initiatives at state reform, including the 13<sup>th</sup> amendment, the Mangala Moonesinghe Commission, the Kumaratunga constitutional devolution proposals, and the 2002-2006 peace process. Even the Rajapaksa government went through many of the motions of a negotiated political settlement - while the LTTE still existed - through initiatives such as the APRC process in the 2006-2008 period. In contrast, there has been a marked decline in the urgency and seriousness with which the government has pursued a political solution since the end of the war.

There is one final consequence that the elimination of the LTTE and the eclipse of the Tamil nationalist project bears in the coming years. Sinhala nationalism had for years sustained itself primarily on the basis of a serious threat perception from a viable counterpart. Such a threat has in the past provided the Sinhalese as a whole with a greater sense of a shared political community that has counter-acted and superseded other forms of political

and ideological identity. This threat emanated more generally from the Tamil nationalist project, but more specifically from the way in which the LTTE was perceived to pose an existential threat to the authority, security, and integrity of the Sri Lankan state and to the collective safety and well-being of the Sinhalese people at large.

What this implies is that despite the fact that Sinhala nationalism now stands triumphant militarily, wields vast influence, and is deeply insinuated into the structure of state power, the defeat of the LTTE has also paradoxically brought the basis of Sinhala nationalism into question, as well as the urgency with which its natural constituency coheres. This absence of a commensurate counter-part does not necessarily imply that Sinhala nationalism is likely to enter into decline, but it does suggest that the basis for its reproduction will likely evolve and change. To some extent, the hostile pressure on human rights and war crimes from western countries, and the continued activism of the Tamil diaspora has provided an alternative point of focus for the reproduction and evolution of Sinhala nationalism in the coming years.

- (ii) The impact of the 2010 elections: Under the 1978 Gaullist constitution, and with the switch to a proportional representation voting system with the 1988 parliamentary elections, Sri Lanka entered an era of coalitions and an end to one-party dominance (Wilson 1981). In contrast to the general elections of 1970 and 1977, which produced clear majorities for the SLFP and UNP respectively under the ‘first-past-the-post’ system, the PR elections of 1994, 2000, 2001, and 2004 all produced fragmented mandates and unstable governments. This instability was one of the most important factors in the domestic political and policy-making landscape, as governments had to perpetually negotiate and re-negotiate terms with minor coalition partners that enjoyed disproportionate influence. Moreover, although it succeeded in offering minority communities a demographically proportional share of seats in parliament, the PR system also formed a serious obstacle in bringing about a political and constitutional resolution to the ethnic conflict.

As the experience of the devolution debate and the Kumaratunga constitution draft of August 2000 demonstrated, the diffuse mandates that PR created made it very difficult for any government to win the two-thirds majority of 150 seats required to pass constitutional amendments, while making it easy for ethnic outbidding to coalesce to achieve the ‘one-third plus one’ required to block such amendments. Nevertheless, in the parliamentary elections of April 2010, and under the benefit of a wave of post-war popularity, the UPFA of Mahinda Rajapaksa has won the kind of victory and majority in parliament that the multi-member constituency PR system was explicitly designed to prevent.

The passage of the 18th Amendment to the Constitution in September 2010 was historic not just because of the far-reaching implications of its content, but also because it is only the second such amendment to have passed in the 22 years of PR. The Rajapaksa government has thus overcome one of the most serious in-built obstacles to institutional change that the 1978 constitution imposed. Together with its overwhelming parliamentary majority, strong ideological legitimacy among the majority community and authoritarian/military suppression of potential sources of opposition, the government now has domestic political supremacy and an unprecedented degree of power and authority.

## **4.2 Domestic political drivers of change**

The stability of the present policy environment and domestic political context depends heavily on the continued dominance of the ruling government, and the weakness of the main opposition. The primary drivers of a change in the policy agenda and environment as a result would be a change in either of these two elements. On the government side, the effective exercise of power depends on a series of interlocking relationships within the Rajapaksa family, the ruling UPFA coalition, and a series of ancillary institutions such as the Buddhist hierarchy, and the military establishment. Some of these relationships are held together by strong institutional, ideological, or family-based bonds, and are hence more enduring. Many other elements are connected with very pragmatic, transitory, and contingent economic and political links, and can thus dissolve quickly if circumstances change.

Under these conditions, the key drivers of domestic political change would be (i) the dynamics of continued cohesion within the ruling coalition and the highest ranks of the ruling elite, including the Rajapaksa family; (ii) revitalization of the opposition, including the UNP or JVP, potentially with the return of Sarath Fonseka; (iii) a

crisis of legitimacy or a moral crisis that affects public perceptions of the government. These are not exclusive elements of a changed political landscape, but are likely to operate as constituent, mutually reinforcing components of a broad process of change.

Political Cohesion: For the purposes of understanding the drivers of change, there are two elements of political cohesion that can be identified - the inner circle of power at the apex of the executive; and the broad UPFA coalition of at least ten different parties that won the April 2010 elections.

At the apex of the executive, political cohesion is defined by the close family relationships that connect the inner circle of power (see Section One). This inner circle enjoys a relationship of implicit trust, confidence and access to the President, and as such, has a 'force multiplier' effect in extending and projecting his authority, influence and capacities into a number of other spheres in state and society. A rupture within, or transformation of the composition of this inner circle can have significant repercussions for the government's ability to manoeuvre within and manipulate the domestic political landscape with the same degree of effectiveness. This unprecedented concentration of state power within the Rajapaksa family has also increased the stakes for the present ruling elite to cling to power, and affects the extent to which they are willing to bend institutions, standards, frameworks, and state-authority to this end.

At a very different level of political cohesion, the government's ability to pursue a legislative agenda, including constitutional amendments, depends on the continued support of the UPFA coalition. Due to the top-heavy distribution of power and the system of patron-client relations that it fosters, there are strong incentives for parties and individual parliamentarians (regardless of their ideological colouring or political base) to join the government, and strong disincentives to dwell for long in opposition. The UPFA comprises parties as diverse as the explicitly Sinhala nationalist Jathika Hela Urumaya (JHU), the up-country Tamil-based Ceylon Workers Congress (CWC), and the Trotskyite Lanka Sama Samaja Party (LSSP), all of which cohere within a coalition of convenience that will prevail as long as it is able to distribute the material rewards of political power to its partners. As a logical corollary to this, the coalition can loosen and shrink in size quite quickly if there is a viable opposition that gains momentum or if the patronage system becomes excessively concentrated in the hands of an inner circle at the expense of the outer circles of power-holders and coalition members. Such dynamics may also surface as a reaction to unpredictable trigger-events that can loosen coalition support, provide channels for internal dissent, and weaken the government's grip on power.

Revitalised Opposition: Sri Lanka's main parliamentary opposition consists of three major components: (i) the United National Party (UNP); (ii) the Janatha Vimukthi Peramuna (JVP) / Democratic National Alliance (DNA); (iii) The Tamil National Alliance (TNA). Of these, the UNP, which is the largest and potentially most powerful force, with 60 seats in parliament, has been in a chaotic state of weak leadership, internal torpor, seen the steady defection of elected MPs to the UPFA, and the widespread demoralization of its rank-and-file. The DNA, with 7 seats, and the TNA with 14 seats are far smaller entities whose effectiveness and future capacity to pose a direct challenge are limited by their small parliamentary and electoral base.

Of these, the extent to which the UNP is able to revitalize itself, and provide leadership to disaffected pieces of the UPFA coalition is a key driver of change. The UNP has been led by Ranil Wickremasinghe since 1994, whose weak leadership and lack of popular appeal are widely viewed as the source of the UNP's failures. The chief contender for UNP leadership is Sajith Premadasa, son of former President Ranasinghe Premadasa, who many party cadres consider to be more closely attuned to the popular political pulse, although his leadership skills have not been tested. At the time of writing, the likelihood for such a transformation within the UNP remains weak, both because of the depth and duration of its internal problems, but also because of the extraordinary track record of the Rajapaksa presidency in disarming and outflanking political opponents.

In contrast to the UNP, it is the JVP that has emerged as a more imaginative and effective source of opposition to the government since the end of the war. Although it has a weak legislative presence and draws on a narrow electoral base that historically accounts for only around 10 percent of the Sinhalese vote, the JVP is adept at magnifying its presence as an opposition party due to two factors. Firstly, the JVP has a formidable grass-roots organization and retains strong influence among politically vocal constituencies such as university students,

where its cult of radical oppositionism to the status quo thrives even under a Rajapaksa presidency. In addition, the JVP also operates along a moral register and deploys a political vocabulary that resonates strongly and connects it emotionally with the UPFA's own core voter base (see Section One for more details).

While the revitalization of the UNP would largely imply reactivating dormant and disillusioned party workers and historically pro-UNP constituencies largely outside the reach of the core UPFA/Rajapaksa voters, the JVP's oppositionism, involves chipping away at the allegiance of this very core. It is important to bear in mind that the JVP has a limited electoral base, and is unlikely to emerge as a viable second party in its own right, although its agit-prop activism has frequently served as a powerful vehicle to articulate and channel latent source of anti-government discontent.

Moral/Legitimacy Crisis: As outlined in Section One, the Rajapaksa government draws a significant part of its legitimacy from its use and patronage of Sinhala nationalism and from the moral authority that this provides. Despite the overwhelming support that the government enjoys in the majority community, there are limits to what even this core constituency will tolerate of its actions. The arrest, trial, and imprisonment of former Army Commander and presidential contender, Sarath Fonseka is one such recent action that has drawn widespread public disapproval. Similarly, the physical intimidation of the media and the attacks and harassment of opposition political personalities are viewed with public distaste, and can coalesce into a sustained withdrawal in the government's popularity. Finally, there is clear public distaste at government corruption, and at the concentration of powers and patronage within the extended Rajapaksa family.

Evidence of this last issue is apparent even among leading coalition members with key cabinet positions, who have been very candid in interviews about the instrumental nature of their allegiance, and of their strong disapproval of many of the actions of the Rajapaksa family.<sup>113</sup> The moral/legitimacy deficit that the government is accruing on several fronts remains latent and diffuse, and has not yet acquired political potency for two reasons. Firstly, the government still retains a bountiful surplus of legitimacy and support among its core constituency for having won the war. Although this does have a limited shelf-life, it remains at present sufficient to balance out actions that are perceived as illegitimate. Secondly, public discontent over corruption, Sarath Fonseka's treatment, or civil liberties violations has not reached maturity yet, and has not been articulated and championed with the extent of persistence, zeal, and competence that will make a mark on the public imagination. This is likely to be a 'slow burning' driver of change that is unlikely to have an immediately influence on events. It is also likely to interact with other factors of change, including the emergence of a viable opposition, economic factors such as the rising cost of living and perceptions of unequal development over the course of the electoral cycle.

### 4.3 Economic Drivers of Change

Crisis: As the experience of the balance of payments crisis in late-2008 showed, the Sri Lankan economy is vulnerable to a number of internal and external factors. Internally, the recent crisis highlighted structural problems such as the high fiscal deficit and the growing debt burden. The 2008 crisis and the poor management of oil-hedging strategy that year also raised questions about the technical management capacity in monetary and fiscal policy (see Section Two). Externally, Sri Lanka remains dependent on external trade and investment, and has high rates of foreign debt and interest payments. Given the growing dependence on investments from China and India, a reduction in economic growth in those two large economies can have knock-on effects in reduced trade, investment and growth in Sri Lanka.

Episodes of economic, political and military crises have closely overlapped in recent Sri Lankan history, such as in 2000/01, and 2008/09, and have strong spillover effects on one another. Arguably the Rajapaksa government was able to overcome the heavy political cost of the economic crisis and double-digit inflation only because it occurred in the last months of the war, and also because the crisis itself was resolved relatively quickly, leading

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<sup>113</sup> Interviews with ruling coalition partner member, August-September 2010.



straight into the euphoria of war victory and period of high economic growth. A second, sustained economic crisis, even if it is largely externally driven, can have strong political consequences, particularly given that the government that has staked its second term on economic success.

Development model: Post-war Sri Lanka is undergoing a phase of rapid economic growth, high rates of foreign investment and the ‘opening’ of the economy in the north and east and its resources to national and international investment. There are two key dynamics to observe with regards to this development model. Firstly, the economic sustainability of the model is questionable, particularly given that it depends on continued high rates of foreign investment. At present, the momentum of pent-up post-war demand, the improvement in the security situation, the opening of ‘new’ areas in the north and east and the large infrastructure projects committed and underway are adequate to carry the current level of economic growth forward for the next three years. Beyond that, there needs to be a much clearer articulation of the sectors identified for growth and investment and a more committed and effective strategy to sustain the development model forward. Secondly, even if the developmental model succeeds in terms of its sustainability, it will generate distinct internal political dynamics based on perceptions of the distribution of its costs and benefits along communal, geographic, and other axes of social cleavage. The historical experience in Sri Lanka demonstrates that large, transformative developmental change, even where they are communally inclusive, are often interpreted and politicized in terms of the ethnic maldistribution of resources.

Poverty-Inequality and the Agricultural Crisis: Sri Lanka’s small-holder agriculture sector has been in a state of secular decline for over a century, and the dynamics of change, poverty-alleviation, and inequality in this sector will have significant social and political consequences in the medium to long-run. Many social, political, ideological, and developmental dynamics that have taken place since the 1930s have occurred in the context of social class transitions out of small-holder agriculture and the diversification of incomes and livelihood strategies beyond the family farm. Since the 1980s, the continued decline in agricultural incomes has been mitigated by the availability of new options such as emigration, garment sector employment, and military recruitment. It is unclear what impact the present post-war development model of capital-intensive infrastructure-led growth will have on the agricultural sector, or the extent to which the government will be able to address policy attention to this sector. For example, a decline in military recruitment, migrant workers or the garment industry can have significant effects on rural poverty-alleviation and turn the clock back to the earlier period of high growth and low poverty alleviation during the 1990s (see Section Two).

#### **4.4 Risks of a Resurgence of Violent Conflict**

The nature of Sri Lanka’s war termination and the legacy it has left on both sides is such that it strongly precludes the possibility of a reversion to the same type and scale of violence. In that sense, the Sri Lankan army’s defeat of the LTTE in May 2009 signified the end not just to a 26 year old civil war between two armed combatants, but to an extended and intense period of political violence that engulfed state and society (Senaratne 1997). This is not to suggest that the risk of violent conflict has been eliminated in Sri Lanka, or even that the underlying political, economic, and social dynamics that animated the conflict are no longer present or relevant. But the phase of violence that was ignited in the early 1980s, and then expanded and became self-sustaining in its logic (Kalyvas 2006) and internal dynamics through the next two decades has died down and exhausted itself to the extent that it is unlikely to re-ignite spontaneously, or at least not in the same form and scale.

While many of the structural circumstances of Sri Lanka’s ethnic conflict continue to fester unaddressed in the post-war period, the ideological, political, social, and international circumstances that provided the organisational raw materials to transform grievance into insurgency in the 1970s and early 1980s no longer exist and would be extremely difficult to reproduce. This section addresses the possibility of a resurgence of the LTTE, and then outlines four axes of tension that have the possibility of escalating into violence.

*LTTE/post-LTTE*

Can the LTTE come back to life and strike again? At first glance, the conditions for a resurgence of Tamil militancy in Sri Lanka are strong. The underlying issues that drove the conflict remain vivid; there is widespread distrust, hostility and bitterness among Tamils towards the government and the president; there is poor commitment or prioritisation of a post-war political settlement, justice or reconciliation. Over the course of three decades, the LTTE also left a deep imprint on the psyche of the Tamil population of the north and east in terms of its ideology and outlook. Due to the LTTE's expansive recruitment policy of 'one child per family', and the growth of their quasi-state apparatus, there are also tens of thousands of former LTTE cadres, employees, collaborators, and 'martyr families' alive in the north and east. In addition, there vibrant, well resourced networks of pro-LTTE activists abroad in the Tamil diaspora.

Indeed, more than a year after the LTTE's comprehensive destruction and the death of its leader Velupillai Prabhakaran, rumours abound among Tamils in the north and east and abroad that Prabhakaran is still alive, and that re-grouped LTTE units are poised to strike from the jungles of the Eastern province (Jeyaraj 2010c). Nevertheless, not only does all the available evidence on this subject indicate that this is not the case, and that the LTTE has become defunct within Sri Lanka, but the likelihood that a quasi-LTTE force can be resurrected to fight again in its old form as an insurgent military/political organisation remains very low. While it is impossible to rule out the possibility that isolated, wildcard incidents of violence will occur in the name of the LTTE, there are two factors that significantly diminish the possibility of a sustained resurgence of militant Tamil separatism.

Firstly, the Sri Lankan Tamil community is exhausted, scarred, depleted, and impoverished from decades of war, and has entered a defensive mode of survival and self-preservation. While there is still little open criticism or re-evaluation of the LTTE and its methods from within, it is apparent even among the more stridently Tamil nationalist segments of the north and east that there is no longer any appetite for the LTTE's brand of militant insurgency. One former LTTE sympathiser in Batticaloa described that although he remained committed to the ideals of the 'struggle', he was firmly convinced that the 'LTTE phase' of armed militancy was over.<sup>114</sup> Other informants felt that Tamil militancy could re-ignite, but not for another generation.<sup>115</sup>

Secondly, the threat of an LTTE resurgence is the primary security concern of the government, who, in the absence of war, have devoted the enormous resources at their disposal to address this likelihood. The attitude that underlies this approach is best described in the words of a senior army officer, 'it took us thirty years to defeat terrorism. We will never let it happen again.'<sup>116</sup> Security concerns and surveillance of potential nodes of LTTE activism have been prioritised in virtually all aspects of life in the north and east, including the return of internally displaced persons, ex-combatant rehabilitation, economic development, relief agency operations, and access restrictions to the north and east for foreign passport-holders (which includes most of the Tamil diaspora). As outlined in Section One, there is a heavy, permanent security presence being established in the formerly LTTE held Vanni, with a network of new camps effectively re-asserting the military authority of the Sri Lankan state in the area.

In sum, the conditions for a resurgence of Tamil militant separatism in the north and east of Sri Lanka are weak due to both 'pull' and 'push' factors. However, the sheer absence of violence in the present environment is itself ephemeral in many ways, and belies the deep-seated and embedded forms of 'structural' violence, and the widespread alienation of the Tamil community at large. The loosening of some of the highly centralised structures of violence and tightly defined ideo-political polarities within which these tensions became expressed creates the conditions – common to other such war to peace transitions – within which war-time violence can metastasise and mutate into other forms of social, criminal or domestic violence. Indeed, the logic of insurgent violence is such that once unleashed, it continues to reappear in a self-sustaining dynamic over time in forms and spaces unrelated to the original forms and tensions that gave rise to it. There is considerable anecdotal and interview-based evidence from the north and east (although as yet little systematic evidence) to indicate the transformation of war-time violence in this manner into the pseudo-criminal violence of the post-LTTE paramilitary groups.

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<sup>114</sup> Personal communication, journalist, Batticaloa, December 2010.

<sup>115</sup> Personal communication, senior army official, Colombo, December 2010.

<sup>116</sup> Personal communication, Colombo December 2010.

While the possibility of another large-scale armed insurgency is low, there are a number of nodes of tension where localised conflicts can emerge and escalate in its place, and through which the latent tensions that prevail can become manifest and find focus.

#### *Security forces and residents in the north and east*

The presence and behaviour of the security forces, the location of army camps, and the demarcation of high-security zones (HSZs) are long-standing factors of tension with the north and east population. At the end of the war in April 2009, some 18 percent of the land area of the densely populated Jaffna peninsula was carved out into 18 HSZs that cover 190 sq km of land in which some 30,000 families were originally resident (Fonseka & Raheem 2008). In the most recently designated HSZ in Trincomalee, some 7,000 people from the four *Grama Niladhari* divisions of the Sampoor area who were displaced during the conflict there in August-September 2006 have been denied access to return to their homes and have been offered alternative locations for resettlement (Fonseka & Raheem 2009). The establishment of a network of new, permanent military camps in the north and east and the permanent presence of high levels of military personnel in the north and east also raises the possibility that this will become a focal point for tension.

#### *Inter-communal friction*

There have been sporadic and localised incidents of friction and violence between Tamil, Muslim, and Sinhalese communities, both during and before the war, particularly in areas of changing demographic composition, socio-economic and political rivalries, and the presence of paramilitary groups. There are four key axes of tension to consider: (i) Sinhalese-Tamil conflicts in the north and east, particularly relating to recent arrival of Sinhalese settlers or businessmen; (ii) Tamil-Muslim tensions in the east, often relating to land disputes in adjoining peri-urban areas, the return of Muslim land-owners in formerly LTTE-held areas in the interior of the east, political rivalries relating to the control and distribution of state resources in the Eastern province, and the presence of armed Tamil and Muslim paramilitary groups; (iii) intra-Muslim tensions between rival religious factions.; (iv) Sinhalese-Muslim tension in the south, particularly in smaller market towns of the Central, Southern and Western provinces, where commercial and political rivalries have fed occasional outbreaks of violence such as in Mawanella during May 2001.

#### *State authoritarianism*

In the highly militarised environment of contemporary Sri Lanka, there is in general a greater readiness on the part of the government to use coercive means to address dissent and opposition from a variety of civil society activists and social constituencies, including the media, university students, trade unions, and even the urban poor and destitute pavement dwellers. With strong executive powers, weakened accountability mechanisms, and a culture of impunity, there is a growing risk that over-zealous security forces will significantly over-step their bounds and generate incidents of disproportionate, one-sided violence in containing anti-government activism.

#### *Civil-Military and Intra-Military Tensions*

The presidential candidacy of former army commander Sarath Fonseka, and his subsequent arrest, trial and imprisonment highlight a number of problems relating to civil-military relations and intra-military tensions. The Sri Lankan army is the single biggest employer in the country and has, in the course of the last phase of the war, grown immensely in public stature and power. More broadly, the politicisation of the military, and the militarisation of politics that occurred during the war years has the possibility of spinning off into new and dangerous confrontations. At the time of the presidential elections in January 2010, the army was said to have been deeply divided between Rajapaksa and Fonseka, and many soldiers are very uncomfortable at the humiliating treatment accorded to their former commander. The extent to which Rajapaksa has been able to aggressively re-assert his authority over the military, punish Fonseka, and marginalise senior Fonseka loyalists has suppressed any overt signs of discontent within the institution. However, the elevated social status and popularity that the army and the *ranaviru* have gained as the moral custodians of the nation has implicitly positioned it much closer to the sphere of political power.

In conclusion, the circumstances of the termination of the Sri Lankan civil war have largely precluded the possibility of an early resurgence of violence of a similar scale and organisational sophistication. While it is impossible to categorically dismiss the possibility that LTTE-style violence can recur, the likelihood of a sustained resurgence of a comparable magnitude is very weak. Instead, the prevalence of unaddressed Tamil grievances and the expanded militarisation of society have been identified as potential flashpoints of localised violence.

More broadly, the drivers of change in the political and economic landscape of contemporary post-war Sri Lanka are limited in their operation. Compared to the previous SCA of 2005, there are fewer variables, actors and trajectories at play, and a smaller range of viable future scenarios. In the short term, the major threats identified to Sri Lanka's political stability and policy outlook are of largely unpredictable political or economic events. In the medium to longer term, the kinds of social tensions that arise will occur in the course of Sri Lanka's pursuit of a more Asian-oriented model of authoritarian developmentalism are likely to assert a greater importance. On the one hand, political developments under the Rajapaksa government are increasingly centred on an inward-looking, nativist, nationalist, authoritarian outlook that is frequently hostile to many elements of global integration, neo-liberal policies, and economic inequalities. On the other hand, the economic side of this model is based on an embrace of global economic integration, foreign investment, high rates of economic growth, and structural economic transformation that can generate rising social tensions.

## SECTION FIVE: CONCLUSIONS AND RECOMMENDATIONS

### 5.1 Wider Lessons

A careful analysis of recent international interventions in Sri Lanka yields important insights about the declining currency and effectiveness of western interventionism, associated with a shift in the geometry of power at a global level. First, it reinforces the lesson that western efforts to engineer a particular kind of 'liberal peace' may often meet resistance, leading to unexpected and sometimes perverse effects. Paradoxically the more vocal and intrusive western actors are, the more they run the risk of undermining their own declared goals as they play into local discourse relating to sovereignty and neo-colonialism. As argued in the previous SCA this suggests the need to be realistic about donor leverage and to be more attuned to the dynamics of domestic politics and how legitimacy is created and sustained in such contexts. Second, liberal peacebuilding, perhaps increasingly, represents a minority position in many parts of the world. The Rajapaksa regime benefited from a global power shift from West to East, and perhaps a recalibration of norms related to sovereignty, internal conflicts and their resolution. Third, the global war on terror helped create an enabling environment for the regime, providing a language to undermine the LTTE and justify the war for peace. Relatedly, the conduct of western actors in Afghanistan, Iraq and elsewhere, under the name of the war on terror, undermined their legitimacy and leverage, particularly in relation to the promotion of human rights and peaceful conflict resolution in the developing world.

This does not mean that Western actors no longer have strategic interests or relevance in the Sri Lankan context, but there is a need to appreciate new political realities and constraints, as noted in a recent Centre for Strategic and International Studies (CSIS) report which argues for 'a more subtle and sophisticated approach, recognizing that the political game has changed in Sri Lanka' (Dukkipati and Schaffer, 2010:3). In many respects, as mapped out in Section One, this is a very old political game, based upon the 'trinity' of Sinhala nationalism, patronage politics and securitized development, but the position and leverage of western actors within this game has radically changed.

The Sri Lankan case also highlights several important lessons for development donors. First, as emphasized in the last SCA, development aid cannot 'buy peace' – just as the peace process showed that a particular liberal version of development (associated with state reform and the creation of a peace dividend and linked conditionalities) did not represent a short cut to security, current hopes that that state-led (but donor funded) development in the north and east can blunt the secessionist impulse and substitute for devolution appear to be wide of the mark. This case reinforces a point emphasized in the literature on aid conditionality: aid budgets are unlikely to buy influence. Aid alone cannot force a recipient to do something that they would not normally do (Burke and Mulakala, 2010). Donors during the peace process mistook a temporary convergence of interests as evidence of significant leverage. Second, conscious politicization of aid during the peace negotiations ultimately had a significant 'blow back' effect, in the sense that it reinforced a view within Sri Lankan society of donors as neo-colonial and invasive – a perception that continues to be a burden on donors today. To a great extent donors are now suffering the consequences of their previous engagement in 'peacebuilding'. Third, the aid agenda, encapsulated in the Paris declaration and OECD/DAC principles emphasizing ownership and partnership, provides few convincing answers to the challenges of working in a context of a strong, but exclusionary state able to exert ownership over its development agenda.

Therefore, the political and policy environment has changed markedly since 2005 and a new (exclusive) political settlement has been forged and this political equilibrium, in our view, is likely to remain stable for at least the remaining term of the Rajapaksa Presidency. Donors need to plan with this likely scenario in mind. As already highlighted, the donor landscape has changed as a result of a conscious tilt by the government towards 'non traditional' and commercial finance, in order to create policy space. Consequently there has been a decline in the size and influence of western funders. As result of these two factors, the scope for western donors to influence key drivers of change is extremely limited. And this leverage is even further diminished as a result of the fragmented nature of the donor environment – 'likeminded' and 'partially likeminded' donors are less than the sum of their parts because their long term goals have become less clear, the costs of engagement have increased and consequently development efforts have become more diffuse and ad hoc, something that has been accentuated by the GoSL's conscious strategy of dividing and intimidating donors. Donor strategies must

be cognizant of these points and maintain a sense of proportion about their significance and leverage in the Sri Lankan ‘political marketplace’. Sri Lanka’s political elite has a great deal of autonomy in decision making and the current administration has very successfully contained or co-opted key drivers of change.

## 5.2 A ‘steady state’ external environment?

In the previous SCA it was argued that diplomats were too timid and donors too bullish. In our view we are unlikely to see any major diplomatic initiatives in the direction of a more inclusive political settlement. The ‘war for peace’ demonstrated that even more ‘bullish’ diplomatic activity had little effect on the government strategy. Our analysis indicates that there are few decisive drivers of change likely to emerge from the international sphere. India is unlikely to push any harder on devolution and the Tamil Nadu elections have shown that in the current context Indian Tamil politics is unlikely to be a crucial factor. The GoSL will continue to exploit geo-strategic competition between India and China, and the US may push on the issue of war crimes but is unlikely to play a more significant role on other fronts, deferring to India as the regional hegemon. Other western actors do not count Sri Lanka as a priority and there are unlikely to be any new major policy initiatives given the perceived intransigence of the current regime. The overriding impulse is to ‘normalize’ relations and consolidate the peace.

There will continue to be pressure applied on the issue of war crimes and human rights violations, through the Ban Ki Moon panel. However the panel has no investigative capacity or remit and any substantive recommendations on accountability are likely to be blocked by Russia and China in the UNSC. India has been more ambivalent on this question and has at times indicated that it will not stand in the way of war crimes investigations. Domestically-led (i.e. the LLRC) or regionally influenced approaches to accountability and human rights are likely to be exercises in evading rather than addressing accountability.<sup>117</sup>

As already mentioned there appear to be no other existing or potential fora with the capacity, legitimacy or interest to generate significant pressure for a more inclusive political settlement. In the realm of track two diplomacy there are various initiatives going on, but given the top down, elitist nature of Sri Lankan politics, such groups may play a useful support role but are unlikely to have a game-changing influence.

The most significant external influence is likely to be economic rather than diplomatic. This will take time to gather pace, but closer integration into the dynamic economies of southern, south eastern and eastern Asia is likely to have a range of complex and unpredictable effects. This will lead to new processes of capital accumulation, new social forces and new political dynamics – leading over time to growing contradictions and pressures for change. How the current regime handles the tension between its centripetal political tendencies and the centrifugal effects of market led growth will be the key to Sri Lanka’s future stability.

## 5.3 Development donors

There are no obvious solutions to the dilemmas and challenges faced by development donors that have been mapped out above. All options involve risks, compromises and costs in relation to donors’ autonomy, goals and principles. It is largely about making ‘least worst’ choices, based on a sound benefit-harm analysis.

Our assumption is that this complex and sometimes hostile environment will continue. Whilst there is always the possibility of a *detente* between western donors and the government, it is equally possible that relations may further deteriorate, particularly in relation to sensitive pressure points like war crimes and accountability.

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<sup>117</sup> For example Dayan Jayatilaka (2010b) has advocated closer collaboration between Sri Lanka, the Asian region and the global South on human rights issues, ‘building up South-South linkages and learning best practices from democracies of the global South.’ But few have any faith in an ASEAN or SAARC approach to human rights, based upon the track records of many of their member states.

It has been argued that at the end of the war international actors debated the pros and cons of a ‘pragmatic’ and ‘principle-led’ engagement and ultimately most came down in favour of the former (Ropers, 2009). However, perhaps this dichotomy is overly simplistic, and there is a need to move beyond the assumed polarity between unprincipled engagement and principled disengagement. This could mean exploring areas where there may be common interests and ‘parking’ issues where there are clear and irreconcilable differences. Or at least there is scope to explore a more optimal division of labour between different constellations of international actors, so that there is a more strategic complementarity between the ‘principled’ and ‘pragmatic’ and between advocacy and delivery.

The situation is not static, spaces may open up, and the government is sufficiently pragmatic to want to maintain relationships with western donors, though on its own terms. As already noted, its economic policies are not so different from the UNP’s, many members of the current administration were also in the previous government and at a local level, much goes on as before. In terms of poverty reduction and the MDGs the Sri Lankan government is unquestionably a good performer and consequently there are significant areas of overlapping interests between the regime and western donors. Furthermore, though in absolute and relative terms western donors are of declining significance, they have a disproportionate role in the north and east because they fill important gaps – in humanitarian programming, resettlement and reconstruction – which for the most part are not adequately covered by ‘non traditional’ donors or commercial lending.

Donors wishing to support moves towards an inclusive political settlement and equitable peace will need to build a capacity for sound political judgment and a careful and subtle calibration of political and economic messages. This necessitates improved coherence and consistency across different areas of engagement – so for example policies related to trade, aid, migration and rights do not work at cross purposes and all are equally conflict sensitive. Tackling conflict issues head on carries the risk of getting entrapped in the quagmire of local politics (Uyangoda and Bastian, 2008:70), and therefore such issues may have to be tackled obliquely or by stealth. This may mean a shift towards more foundational work, which would involve engaging with long term processes rather than pre-defined outcomes, supporting areas of work where there may be common ground with elements of government and identifying low risk opportunities that can be supported by donors and relevant (non)governmental actors. It would also mean bidding one’s time, readjusting time frames and policy objectives, and not expecting to generate quick and visible policy ‘bangs-for-your-buck’ in the short term.

## 5.4 Recommendations

The primary end users of this report are expected to be the so called ‘likeminded’ and ‘partially likeminded’ donors. We have therefore divided our recommendations accordingly, whilst recognizing there is considerable overlap between these two groups of actors.

### *To the ‘likeminded’ donors*

These donors have come under steady attack because of their focus on issues to do with rights, governance and peace. Whilst as funders they are of declining importance, these donors continue to have a significant role, particularly in three areas:

*First*, as humanitarian and human rights advocates. Institutional and financial interests, notably disbursement pressures, have prevented larger humanitarian and development agencies from taking on this role. The prioritization of access and delivery over advocacy has been a feature of agency practice in the war for peace and ‘post war’ periods. There is perhaps a need to more clearly separate out and strengthen the advocacy role of a small number of likeminded donors – some of whom could perhaps play this role more effectively if they were less constrained by questions of access and delivery. The withdrawal of this group of actors would further cede ground to nationalist groups and leave Sri Lankan civil society organizations promoting human rights further exposed. However, withdrawal must be retained as an option and if acted upon should be done in an extremely visible and transparent way with the reasons being made very clear to the government and relevant international

fora. Stronger, more coordinated and consistent backing is required from the diplomatic community, who have too easily been cowed and divided by the government.

*Second*, as small scale funders of more ‘risky’, and ‘political’ areas of work including civil society support, peacebuilding, justice and human rights. In our view, if the likeminded donors were to withdraw altogether from these areas of engagement, there could be a significant closing down of political and civil society space. If nothing else, this kind of work constitutes a ‘holding operation’, one of maintaining spaces and institutions that might otherwise disappear. This is stated in the firm knowledge that some civil society actors already feel abandoned by traditional donors now that the going is tough. Engagement with civil society actors should also involve tighter and more transparent accountability and auditing procedures which will serve to both avoid the mistakes of the past and to pre-empt the often nationalist-fuelled critique of civil society actors. What may also be required is a rethinking of what constitutes ‘civil society’ so that long-term institutions or processes are also given more emphasis within donor support (e.g. educational processes etc.). Our second point is in tension with the first one, which argues for the likeminded to rethink the relationship between delivery and advocacy, and consequently there may be a need to explore a division of labour within the likeminded, between the advocates and those funding ‘high risk’ projects.

*Third*, as innovators, catalyzers and standard setters. The small, likeminded donors have historically played an important role within the donor community in Sri Lanka. They have often been the source of new ideas e.g. on conflict issues and nodes of expertise and leadership e.g. within the Donor Peace Support Group, and capacity augmenters for the larger donors e.g. placement of conflict advisors in the ADB and the World Bank. Now more than ever the likeminded have an important role to play as capacity builders and influencers of the partially likeminded and the unlikeminded. There may also be greater space for the likeminded to devote time to working outside Sri Lanka with diaspora communities, who continue to have a significant political and economic role.

#### *To the partially likeminded*

For donors with significant resources and a commitment to engage with the immediate humanitarian and reconstruction needs in the north and east, there is perhaps a need for ‘more resources and less rhetoric’ if they wish to influence how development processes are designed and delivered.

There are positive examples of engagement in the north and east but the picture is a mixed one. The partially likeminded in particular need to collectively develop a set of principles of engagement and a meaningful ‘equity’ or ‘social justice’ filter, which they stick to, even in the face of government pressure as the danger in the current context is that such principles can become diluted in meaning or mere lip-service, box-ticking frameworks if clear lines in the sand are not established.

As a basic premise it should not be assumed that reconstruction and development activities represent an automatic investment in conflict prevention and peacebuilding. There is a need to explicitly consider the implications of reconstruction and development efforts in relation to their effects on ethnic relations, access to resources and justice, and whether they are likely to contribute to a more inclusive or exclusive political settlement. These principles of engagement must be jointly negotiated and then closely monitored at all levels. There is perhaps scope for more discussion and analytical work involving the likeminded and partially likeminded to develop ideas on such a filter.

Sectors of work where there may be spaces include – education/youth; rural livelihoods and employment; economic governance and livelihoods; local government, and community based structures such as RDSs and cooperatives; work with the Tamil and Sinhala diasporas. Although these areas will inevitably bring with them their own dilemmas of engagement in the current context, low-key, foundational, long-term work may avoid the surfaces of antagonism, obstruction and delay that the partially likeminded have also experienced in recent times.

As recommended in SCA2, there is scope to explore more fully regional models of reconstruction and economic development, something the government is clearly already doing. Aid organizations might use their networks



within the South/South East Asia region to explore the viability and relevance of such models. This could mean the likeminded and partially likeminded reaching out more proactively to the 'unlikeminded' to explore a range of possible development models that have been tried and tested in the regional context. A dialogue on the division of labour between hardware and software programming could open up opportunities for collaboration between western and eastern donors.

## **5.5 Data gathering, analysis and learning**

First, the lack of reliable data and its politicization was frequently mentioned by interviewees. This was a partly the result of the government's limiting of access, and a reluctance of aid agencies to provide figures, knowing they would be attacked by government officials. However the lack of a strong evidence base – which has historically been an issue in the north and east – has held back programme implementation and advocacy/lobbying. It means that aid agencies are constantly on the back foot. There is a need to develop a much stronger research and data gathering capacity as a wider resource for the aid community potentially utilising the support of actors such as UNOPS, and Sri Lankan research organizations like CEPA. However, capacity in this areas needs to be substantively boosted and a dedicated organization (or strengthening one that already exists), funded collectively by aid donors may be necessary.

There are many lessons to be learnt about the international response both to the peace process and the subsequent war for peace. Whilst recognizing that now may not be a good time for another 'lessons learnt' exercise, for accountability and learning purposes there is a need for a 'meta evaluation' of the international role during this period. Sri Lanka has been a landscape in which tensions and antagonism between international donor engagement and the Sri Lankan state has, at times, been fierce. However, it has also proved a context where there are dangers of unintentional complicity with outcomes that undermine the self-declared principles and goals of donors. Rather than being constrained by the specific contexts that pertain in Sri Lanka, these are universal dilemmas and tensions (albeit varying in intensity) and, consequently, the findings of such an evaluation would have significant implications in Sri Lanka and beyond.

## **5.6 Coordination and communications**

There is scope to develop a more strategic and clear division of labour within the aid system in Sri Lanka, between advocates, donors and operational agencies. The donor landscape has become more complex and characterized by greater diversity with the entrance of non traditional donors. This increased plurality may be a good thing if it opens up the opportunity for domestic actors to experiment with and test alternative development models, particularly those that have been successfully deployed in the regional environment. However, established OECD/DAC fora and coordination mechanisms may become decreasingly relevant and there may be a need to explore alternative groupings and a more strategic division of labour.

Arguably some of the coordination bodies and mechanisms are no longer 'fit for purpose', having evolved in response to a very different set of circumstances. They still tend to be dominated by western donors who are now only a small part of the picture.

There is a need for strengthened coordination mechanisms and leadership, though there are clear reasons why aid has become more fractured so simply calling for 'better coordination' will not address this problem. NGO coordination was consistently mentioned as a point of concern and donors need to look carefully at ways of supporting a process that would help strengthen NGO coordination and representation.

As mentioned above, small-likeminded donors do bring a range of experiences and skills that other donors may lack. Currently the most important tension is between advocacy and delivery and a clearer distinction between

these two and the actors involved could lead to a more coherent approach, involving improved delivery and sharper advocacy messages.

Donor communication strategies have been rather limited and risk-averse. There is a need to explore ways of developing mechanisms and fora to ensure better communication between donor-GOSL. Donors need to learn from the way the government was able to deploy key officials and spokespeople to set the agenda and keep donors on the back foot. There is also a need to reach out and counter more consistently the negative images promoted by the unlikeminded including nationalist groups and the vernacular press.

## ANNEXURE: CURRENT MACRO-ECONOMIC POSITION AND BUDGET ANALYSIS

The war ended in mid 2009, amidst much euphoria for the economic opportunities that would be created. Yet 2009 was not a good year for the economy. GDP growth fell to 3.5 percent, export earnings growth and even growth in domestic consumption demand contracted severely. On the positive side, reported inflation fell to 3.4 percent.

### Macroeconomic position

Investment and expenditure: In 2009, domestic consumption growth was only 4.1 percent of GDP, having been 28.8 percent of GDP in 2008. Private investment declined to a *negative* 6.9 percent of GDP. Foreign Direct Investment (FDI) declined to just 0.9 percent of GDP (from 1.7 percent in 2008).

The 2009 slowdown can be largely explained in terms of private investment and expenditure, taking a turn towards becoming more cautious (private savings increased by 49.5 percent compared to 2008). It is not yet clear how much of this can be attributed to the global effects of the international financial crisis, and how much to domestic factors.

The drop in FDI is particularly puzzling, given the improved climate for investment post-war. It is perhaps important to recognize that political stability, to which FDI is very sensitive, is not only about the ending of war, but about a system that has regulatory stability, policy and macroeconomic stability, and where opportunities and risks are predictable – i.e. information is available and actions are not subject to uncertain holds of patronage and corruption.

Public Debt and government deficit: Both the debt to GDP ratio and debt servicing costs have both increased in the last few years. The combination of a weakening US dollar and post-Tsunami reconstruction based economic growth in Sri Lanka reduced the debt burden from around 100 percent of GDP in 2004 to 81.4 percent of GDP in 2008. But the trend reversed in 2009 increasing the debt burden to 86.2 percent. Much of this increase was met with foreign debt which rose by 3.7 percent of GDP in one year. Of most concern is the fact that the share of commercial debt, within total foreign debt, has risen from 4.4 percent in 2006 to 23.3 percent in 2009.

Therefore, there is now an increased exposure to volatile short-term borrowings and the debt interest servicing costs have increased sharply to 6.4 percent of GDP (they stood at 4.8 percent in 2008 and 5.1 percent in 2006). To put the numbers in perspective, half of all tax revenues are earned from income tax (about 171 billion) and VAT/GST (about 138 billion). The total of that – 309 billion – is equal to what the government is currently spending to service the interest component of public debt.

The management of the budget deficit has also been disappointing. Under the IMF arrangement the deficit was targeted at 7 percent for 2009. The actual deficit was 9.8 percent. The government provided a revised estimate 0.7 percent of GDP (Rs. 34 billion) for Net Foreign Financing of the deficit to the IMF in 2009. The actual turned out to be much greater, at 4.8 percent of GDP (Rs. 230 billion).

Social expenditures: In Sri Lanka, since 2005, welfare expenditures have been decreasing as a percentage of GDP (not counting government pension payments, which are inaccurately classified as welfare). Furthermore, this seems to be an intentional even if not publicised policy, despite public rhetoric with regard to social commitments. The government's Letter Of Intent (LOI) to the IMF in mid 2010 declares that

*“Deficit reduction will take place primarily through a reduction in security-related spending... and a reduction in other non-interest recurrent spending, including by maintaining subsidies and transfers in nominal terms”. [i.e. reducing them in real terms and as a percentage of GDP]*

Health care, education, poverty alleviation and welfare programs in Sri Lanka were severely under-funded in the past to make way for defence expenditure. The intent to depreciate their provision further by “maintaining...in nominal terms” is not in favour of the vulnerable sections of the population, and likely to be unsustainable. A sustainable plan to cut fiscal costs in Sri Lanka may need to investigate other avenues such as public sector reform, reducing wastage and fighting corruption.

Trade and Export Sector: The combination of an over-valued exchange rate and high inflation affected the competitiveness of the export sector. In 2009 exports contracted by 12.3 percent, while the sector came back to positive growth in 2010, exports were still 6.1 percent less than the 2008 level. Textiles and Clothing, which account for about 40% of all exports, have fallen by 10.1 percent between 2008 and 2010, with the majority of this decline coming in 2010 as a consequence of continuing uncertainties surrounding the EU GSP+ scheme.

While exports have contracted by 6.1 percent since 2008, imports have also contracted by 1.7 percent. Altogether the trade deficit has increased by 4.3 percent over the period – a total increase of US\$ 60 million. Nevertheless there has been an improvement in the current account deficit during the period, which has been driven by an increase in foreign remittances of 100 billion or 13.2 percent. In short, the improvement in the current account deficit has not been caused by positive developments in the local economy; it has been driven by a contraction of imports through demand reduction in the local economy and an increase in remittances, from economic prospects outside the local economy. These observations suggest that the Sri Lankan rupee should be on a depreciating trend. The Sri Lankan rupee has however been appreciating in 2010. This is based on the infusion of support from the IMF, remittances, development assistance, and foreign borrowings – i.e. the monetary side of the economy – and not based on the fundamentals of the real economy.

### **Analysis of 2010 budget**

Summary: The government presented its first complete post-civil war budget on November 22nd, laying the foundation for its medium-term development framework and announcing key reforms. The 2011 budget attempts to boost investment and private sector growth through a range of tax reductions and administrative reforms. However, there are several concerns. First, the fiscal implications of budgetary policies are likely to be negative, and deficit targets, on which continued IMF support will hinge, are not likely to be met. Second, while growth targets may seem reasonable on the basis of post-war economic bounce back, there is little real evidence of the bounce back, and the drivers of economic growth remain elusive. Third, the investment growth needed for an 8 percent economic growth is unlikely to be achieved, with FDI actually declining in 2010 contrary to expectations – signalling structural and political weaknesses in attracting investment and economic initiatives.

Tax simplification and reductions: The reforms proposed in the budget aim to overhaul the tax system by reducing tax rates and broadening the tax base. They also aim to simplify tax structures and the administration of taxes. One objective of the reforms is to increase the disposable incomes of businesses and individuals, thereby stimulating investment and domestic consumption and generating greater indirect tax revenue. The reforms are also designed to encourage entrepreneurs to engage in greater value added production and exports.

Key points include:

- Corporate income tax has been reduced to a maximum of 28% from 35%.
- Personal income tax has been reduced to a maximum of 24% from 35%, along with a widening of tax slabs and a doubling of the tax-free income allowance -- from 300,000 to 600,000 rupees per year.
- Public servants, hitherto exempt from paying income tax, have been included in the tax net. However, most public sector salaries are below the new minimum taxable income of 600,000 rupees (or some 5,384 dollars) per year. However, the revenue benefit from this adjustment is likely to be limited since

most public sector earnings do not fall within the minimum tax range (LKR 600,000 per year – increased from LKR 300,000).

- The tax reforms have been manipulated to incentivise entrepreneurs to engage in greater value-added production and exports, using both carrot and stick approaches.

Increasing revenue: Through these measures the government expects *tax revenue* to grow by 19.8 percent in 2011. This is an ambitious target. Out of the projected 142 billion rupees revenue increase from taxes, 56 billion rupees is expected to be generated through trade taxes and 66 billion rupees from goods and services taxes. The biggest cuts have been on income tax, which constitutes a small component of the overall revenue.

Therefore, the major growth in tax revenue is expected from trade taxes (36.2 percent). This projection is based on a number of new cess charges on imported items to promote import substitution, a rationalization of duty free import incentives for investments, along with expected growth in imports in 2011

The deflator used in the budget is approximately 6.3 percent for 2011, which may be an underestimation considering potential inflationary effects of monetary easing. Furthermore, with private sector credit demand recovering as well, there is likely to be upward pressure on prices. The result could be higher inflation and an increase in nominal GDP, which can help to achieve the revenue targets in nominal terms, but may lead to a shortfall in real terms.

The difficulties should not be under-estimated. The total government revenue is expected to rise by 19.1 percent but this target is ambitious even if growth were to meet the government's 2011 target of 8 percent, which also remains ambitious, since current projections are based on a lower than likely GDP deflator (under-estimating the deflator at 6.3 percent implies an over-estimation of economic growth).

Tax revenue from income and domestic trade are projected to be broadly in line with nominal national income growth, and this depends on the assumption that revenue losses through the tax reductions can be cancelled out by the expansion the economy and of the tax base. There is, however, no immediate evidence to support this assumption/projection. The other possibility is that revenue targets are met through nominal economic growth that is fuelled by inflation rising above 10 percent, exceeding the current target of single-digit inflation.

Fiscal deficit: In 2009, the budget deficit stood at 9.7 percent of GDP, and is projected to reduce only marginally to 8 percent this year. The new tax reforms could have a serious impact on the deficit. Yet the government has ambitiously forecast a reduction to 6.8 percent in 2011. Key points include:

- The budget projects a fall in the deficit in absolute terms from 446.8 billion in 2010 to 433.6 billion in 2011.
- The limited growth in expenditure depends on low growth of interest repayments (projected to be 1 percent), which at 354 billion rupees accounts for only 24.9 percent of total government expenditure in 2011. (It was 27.4 percent in 2010)
- Defence expenditure at 223.4 billion (3.6 percent of GDP) has remained the same in nominal terms since the end of the war in May 2009, despite presenting a clear opportunity for significant reduction in fiscal expenditure.
- The lagged effects of monetary easing in 2009, combined with greater international prices of goods, are likely to result in higher inflation in 2011, prompting the Central Bank of Sri Lanka to raise interest rates. While this does not affect existing debt, it will increase the cost of borrowing in 2011.

Investment climate: Although a widely anticipated overhaul of the Board of Investment (BoI) was not realised in the budget, the government has announced a variety of reforms to generate a strong investment climate. Key points include:

- Duty free imports have been rationalised for the Bol companies by imposing a negative list – a list of items which will not be duty free. The negative list contains mostly construction and related inputs that are available from the domestic market, the goal being to promote sourcing of locally produced inputs.
- New tax holidays for investment has been limited to a period of five-years with a minimum investment of 500,000 dollars (though also reported, probably erroneously, as 5,000 dollars in some text of the budget).
- It intends to simplify procedures for obtaining land for industrial purposes.
- More importantly, the government has also announced several measures for improving the investment climate. Namely, the intention to simplify procedures for obtaining land for investments, enhancing ICT usage in financial transactions with the government including tax payments, increased automation of trade processes by implementing trade facilitation measures and relaxation of exchange control measures, allowing local companies to obtain credit from abroad (which is likely to be much cheaper), allowing foreigners to engage in the local corporate debt market, and reduced taxes on banks, which could lead to further relaxation of the credit market.
- Many of these measures are in line with responding to perceived weaknesses in the Sri Lankan investment climate. The low level of foreign and local investment in the last year – despite the optimism from ending the long running military conflict in mid 2009 -- suggests that increasing investor confidence will remain an uphill task.

Challenges: Many of these measures respond to perceived weaknesses in the domestic investment environment. The low levels of foreign and local investment last year, in spite of the optimism associated with the end of the civil war, suggest however that boosting investor confidence will remain an uphill struggle. The main points are as follows:

- In the first half of 2010, foreign direct investment amounted to 208 million dollars (annualised 416 million dollars), substantially less than the 741 million-dollar annual average between 2007 and 2009. This slump is attributable to the impact of the global downturn, and the chronic problems of distortions in the labour market, infrastructural shortfalls and high energy costs.
- The government aims to increase GDP to 8 percent. However, this requires total investment to rise to between 32 percent and 40 percent of GDP (The INCOR has been declining from around 4 to 4.5 over the last decade, signalling a drop in the productivity of investments). Over the last five years, average private and public investment has remained at 21.6 percent and 5.2 percent of GDP respectively.
- The government claimed aim to double per capita income to 4,000 dollars by 2016, does not add up even in terms of the declared projections, unless the rupee appreciates against the dollar. But the RER indicates that the rupee should in fact be depreciating.
- In order to reduce public expenditure, the government will have to reduce or rationalise the fiscal burden, including interest rate payments, salary and pension costs. However, the budget has not outlined a fiscal policy regarding these issues.
- The government would have to choose between maintaining low interest rates to curtail government expenditure at the cost of higher inflation, or raise interest rates to control inflation, jeopardising the debt position. The expenditure projections also assume a real decline in expenditure on subsidies and transfers. This should entail some rationalization of existing subsidies, which have not been outlined as yet.

Infrastructure and overcoming challenges The current infrastructure development programmes, funded largely by foreign investment, are said to be aiming at addressing the long-term constraints to investment. The productivity of these investments, however, are likely to be varied and uncertain.

**Table 4: Summary of Budget 2011**

	<b>2010</b>	<b>2011</b>	<b>Growth %</b>
Income Tax	135	154.9	14.74
Tax on goods and services	429.5	495.5	15.37
Trade taxes	155.5	211.8	36.21
Non-tax revenue	92	101.4	10.22
Grants	16.2	22.6	39.51
<b>Total Revenue</b>	<b>828.2</b>	<b>986.2</b>	<b>19.08</b>
Salaries and wages	295.3	344	16.49
Interest	350.3	353.9	1.03
Subsidies and Transfers	197.2	207.3	5.12
Other goods and services	83.2	111.7	34.25
Education and health	29.4	54	83.67
other infrastructure	329.6	359.7	9.13
other	-10	-10.8	11.36
<b>Total Expenditure</b>	<b>1275</b>	<b>1419.80</b>	<b>11.36</b>
Recurrent Expenditure	926	1016.9	9.82
Capital Expenditure	359	413.7	15.24
<b>Budget deficit</b>	<b>446.8</b>	<b>433.6</b>	<b>-7.72</b>

Calculated Using Data Presented in the Budget Speech (GoSL November 2010). Figures in LKR Billion.

The current infrastructure development programs aim at addressing some of the challenges listed above – and the completion of a key highway project and coal power plant in 2011 should have a positive impact. The budget does not make substantial new infrastructure development commitments, the only proposals are for 20 billion rupees for provincial road development and 300 million rupees for irrigation development. Nonetheless, the ongoing activities covering roads, power, ports and airports will continue to receive government components of financing, while the bulk of funding is from bilateral foreign funding. However, there is no evidence of increased funding to improve train and bus transport, which remains low in both adequacy and quality (and where there may be large productivity gains).

Despite the infrastructure investments there remain challenges to be addressed, particularly rigidities in the labour market, relating to costs of termination of employment and the lack of portability of retirement income schemes between the private and public sector. Furthermore, transport infrastructure in the country remains sub-optimal and energy costs are substantial.

Concluding remarks on the budget The 2011 budget is one of mixed signals. The tax reforms are bold and designed to offer incentives to the private sector to take the Sri Lankan economy forward at a faster pace. But the critical issues of public sector reform and reducing public expenditure have been neglected, creating increasing risks to fiscal stability. Investment growth and the drivers of economic growth also remain uncertain – reducing the confidence one might place on the projected budgetary outcomes. The targeting of public expenditure and foreign borrowing on infrastructure projects are of uncertain benefit when considered in terms of their returns to investment.

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