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The Making of Sri Lanka's Post-conflict Economic Package and the Failure of the 2001-2004 Peace Process

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CRISE WORKING PAPER No. 64
January 2009

DFID Department for International Development *The UK Department of International Development (DFID) supports policies, programmes and projects to promote international development. DFID provided funds for this study as part of that objective, but the views and opinions expressed are those of the author(s) alone.*

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Abstract
This paper explores the role of domestic actors and the international donor community in the evolution of Sri Lanka's post-conflict economic package of 2001-2004. It argues that the inappropriateness of this economic package was a critical element that contributed to the overall failure of the peace process. Due to the heavy influence of corporate interest groups and international donors, the peace agenda, and the country's post-conflict PRSP, was effectively tethered to an aggressive programme of market reforms. Although the government felt that the market reform agenda would spur rapid economic growth and buy support for the peace process, it ended up doing the very reverse. Consequently, the relatively narrow constituency of opposition to the peace process swelled in size and benefited from the support gained from those who opposed the government's economic policies. The market-reform laden economic agenda enjoyed very narrow social support and indeed, generated considerable opposition and hostility. In addition, the government's simultaneous pursuit of fiscal austerity to secure desperately needed concessionary financing from the IMF meant that not only was there very little in the way of a peace dividend to distribute, there were instead cutbacks on subsidies and employment opportunities that disproportionately affected the rural Sinhalese poor. The inherent unpopularity of this economic agenda was compounded by the absence of broad consultation in its formulation, despite the fact that this was required as part of the PRSP process.

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The Making of Sri Lanka's Post-Conflict Economic Package and the Failure of the 2001-2004 Peace Process

By Rajesh Venugopal [1]

1. Introduction

This paper explores the role of domestic actors and the international donor community in the evolution of Sri Lanka's post-conflict economic package of 2001-2004. It argues that the inappropriateness of this economic package was a critical element that contributed to the overall failure of the peace process. It describes how the influence of powerful domestic lobby groups combined with the policy advice of international donors helped to tether the peace agenda to an aggressive programme of market reforms. Although the government felt that the market reform agenda would spur rapid economic growth and buy support for the peace process, it ended up doing the very reverse. Consequently, the relatively narrow constituency of opposition to the peace process swelled in size and benefited from the support gained from those who opposed the government's economic policies.

Many elements of the case discussed in this paper have clear resonance with the growing critique of the liberal peace-building agenda (Paris 2004), which argues that the accelerated imposition of liberal democratic political institutions and market reforms is counter-productive in fragile post-conflict countries. Along somewhat modified lines, I argue here that there was an inherent contradiction between the political and economic dimensions of the liberal agenda: that the Sri Lankan government's attempt to balance a fragile and controversial peace process alongside an equally controversial agenda of market reforms ended up destabilising the government, and brought about the demise of both agendas.

But the more substantial difference that Sri Lanka exhibits from the classic case studies of liberal peace-building is the extent to which this particular policy package was internally driven, and not externally imposed. Unlike contemporary cases of post-conflict peace-building in Kosovo, East Timor or Cambodia, Sri Lanka did not experience the collapse or destruction of governance structures, or the imposition of a top-heavy UN-led state-building mission. Far from it – Sri Lanka has one of the oldest, uninterrupted multi-party parliamentary democracies in Asia with constitutional process and liberal democratic norms upheld (in form if not entirely in content) through the war years. Although this particular policy combination of peace-with-market reforms was advocated, encouraged, and financed by the international community, and was to some extent implemented due to direct pressure and conditionality from the aid donors, it actually came to be conceived and implemented as a result of ideo-political and socio-economic circumstances that were very rooted in Sri Lanka itself, having evolved and come to political fruition largely out of internal circumstances. As such, the thrust of this paper is largely a description of the formulation of this 'domestic liberal peace' agenda, and an overview of the circumstances through which it came to disrupt and ultimately, to contribute towards, the collapse of the peace process.

The material presented here is based largely upon primary material (documents, newspaper articles and interviews) gathered during field trips to Sri Lanka over 2002-2007, and particularly in four months of fieldwork in mid-2006. During this period, I

[1] I am grateful for comments on previous drafts by Frances Stewart, David Washbrook, Nandini Gooptu, and numerous seminar/conference participants at Oxford, Bath, Manchester, and Cambridge.

was able to meet a number of leading personalities from the then-government and ruling party structure, including the prime minister, cabinet secretary, ruling party chairman, and the treasury secretary. In addition, I sought out interviews and documents from members of leading corporate associations and aid donors, such as the Employers Federation, the Ceylon Chamber of Commerce, 'business for peace' NGO organisations, the World Bank and IMF. This material was combined, contrasted and triangulated against a review of the available English language news media sources of that period, translated compilations of the vernacular media, financial statistics, secondary literature, and interviews with a number of trade unionists, opposition political parties, journalists, and civil society activists.

Due to limitations of space, this paper necessarily contains only a small part of the overall research findings and output, such that many important definitional, theoretical, and contextual issues are truncated and cannot be given full treatment.[2] The rest of this paper is organised as follows. Section 2 provides a brief background to the peace process and its failure. Section 3 describes the nature of the electoral mandates that brought the peace agenda into being in December 2001, and that later consigned it to a slow collapse after April 2004. Section 4 describes the making of a domestic 'business for peace' agenda in the late-1990s, and the way this influenced the content of the United National Party's (UNP) peace process when it came to power in 2001. Section 5 describes the role of the international community in the making of the 'liberal peace', while Section 6 explores the logic behind the government's economic policy formulation in its first year in power. Section 7 recreates the way in which the government's Poverty Reduction Strategy Paper (PRSP) was drafted and explains how it clearly subverted the PRSP's own inherent design features, probably as a result of collusion between the government and the IFI staff.

2. Background

The Sri Lankan civil war which started in 1983 is the product of an underlying political conflict that had developed since the 1950s between the island's majority Sinhalese community, and the minority Tamils.[3] By the mid-1970s, the conflict had advanced to the stage of a secessionist demand by the Tamils for a separate state of Tamil Eelam to be carved out of the north and east of the island, and a parallel rise in Tamil militant insurgency groups devoted to this goal. By the late-1980s, the Liberation Tigers of Tamil Eelam (LTTE), or Tamil Tigers, emerged as the dominant force on the Tamil side, remaining militarily undefeated, and having gained control of large parts of the north-east. The war itself carried on through several different phases between 1983-2001, when there were at least four significant attempts at peaceful resolution in 1985, 1987, 1989-90 and 1994-95, all of which failed.

In this context of almost two decades of continuing war and failed peace, the cease-fire agreement (CFA) of February 2002 between the government of Sri Lanka (GOSL) and Tamil Tigers gave rise to the most promising possibility for a permanent resolution to date (Saravanamuttu 2003, Balasingham 2004, Uyangoda 2002, Uyangoda and Perera 2003). Amid a wave of public goodwill and with the strong diplomatic and financial support of the international community, the government of Sri Lanka and the LTTE engaged in six rounds of direct negotiations and had reached substantial agreement on critical conceptual issues. By late 2002, a final settlement of the conflict came clearly and credibly within sight as the Norwegian mediators

[2] For a fuller account of the context and findings, please refer to Venugopal (2008).

[3] On the evolution of the conflict, see De Silva (1998), Manogaran (1987) and DeVotta (2004).

announced that both parties had reached a 'paradigm shift' in their respective positions, and had agreed on the broad outlines of a future settlement:

> the parties have agreed to explore a political solution founded on the principle of internal self-determination in areas of historical habitation of the Tamil-speaking peoples, based on a federal structure within a united Sri Lanka. [4]

The LTTE's chief negotiator, Anton Balasingham, announced that 'both the parties have made an unprecedented historic decision to work out a political formula for the solution of the protracted ethnic conflict.'[5] The lead negotiator on the government side, Professor G.L. Peiris was equally optimistic, announcing: 'I think an interim solution can certainly be arrived at in a matter of months rather than years'.[6]

By then, the cease-fire had already held for an entire year, the longest such absence of hostilities since 1983. There remained numerous irritants on the ground, as well as some clear provocations, but nothing on a scale that could disturb the clear momentum of the peace process. The benefits of peace appeared so overwhelming and self-evident that it seemed irrational that either side would ever want to return to war. There was a warm relationship and considerable goodwill between the LTTE and the government, epitomised by the bonhomie that developed between the two chief negotiators, Balasingham and Peiris. At the ground level, the return to normality was characterised by widespread reconstruction, the return of refugees, the removal of military checkpoints, the de-mining of roads and farmlands, and a general air of reconciliation.

But within three years of the euphoric 'Oslo Declaration', the peace process had unravelled to the point of complete collapse, and both sides were clearly preparing for a renewed phase of war. The key turning point in the peace process was the mid-term election of April 2004, when the UNP-led coalition government that had signed the CFA and negotiated with the LTTE lost power. The government that subsequently came to power was far more chary and guarded in its approach to negotiations, and even though the war did not start in earnest until mid-2006, there was in fact no further progress on the peace process after April 2004.[7] Instead, there was a slow slide towards increased antagonism, and an expansion of the number and scale of cease-fire violations.

What happened? Why was the government that was voted in on an explicitly pro-peace mandate in December 2001, voted out of power just 27 months later? Why, given the extent of its public support, the rational benefits of peace, and the unprecedented progress in the negotiations, did this 'best and last' chance for peace fail? In seeking to address this issue and in making sense of this surprising electoral verdict in this paper, I also unpack the nature of the peace process as envisaged and implemented. Where and how did the peace agenda originate? Does an understanding of its social and ideo-political parentage and its mode of delivery provide any explanations for its quick failure?

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[4] Statement issued by the Royal Norwegian Government at the conclusion of the third session of peace talks between the Government and the LTTE in Oslo, 5 December 2002.
[5] Tamilnet, 5 December 2002, 'LTTE-GOSL reach historic agreement'.
[6] CNN 'Insight' interview, 16 September 2002.
[7] There was a brief window of opportunity for renewed negotiations that opened following the tragic circumstances of the Asian Tsunami of 26 December 2004, but this collapsed primarily due to deep disagreements within the constituents of the ruling coalition.

In exploring the sources of the collapse of the peace process, this paper is deliberately focused only on the (largely Sinhalese) south which was much less affected by the civil war. It does not explore the extent, impact or repercussions of the economic agenda in the north-east – which was largely concerned with rehabilitation and reconstruction – nor the political/economic decision-making of the LTTE, and its not-insignificant contribution to the overall collapse of the peace process. Instead it is broadly aimed at explaining the electoral verdict of the Sinhala Buddhist majority community in the April 2004 elections.

The peace process came into being with the election of the UNP-led government in December 2001, which explicitly promised to end the war by arranging a cease-fire, holding talks with the LTTE and negotiating an interim power-sharing arrangement in the north-east. Conversely, the collapse of the peace process began when this government was defeated in a mid-term election in April 2004. If the parties in parliament can be divided for the purposes of the peace process into those that directly supported it, and those that were hostile to it, then the extent of the vote swing that made and unmade the peace process becomes very clear. In 2001, the UNP share of the vote went up 5.4% from the prior elections, from 40.2% to 45.6%, and they won an additional 20 parliamentary seats. Despite the fact that the UNP itself did not win an outright majority of seats in parliament, they nevertheless enjoyed the strong support of several minority parties (in the other category), and, for the 27 months of their government, enjoyed an unusual degree of internal stability. But by April 2004, in the first subsequent public opportunity to vote on the peace process, their vote share dropped sharply by 7.8% to 37.8%, significantly worse than their situation in the October 2000 parliamentary elections.

Table 1: Voter Swing, 2000, 2001 and 2004 Parliamentary Elections

	Change 2001 vs 2000			Change 2004 vs 2001		
	Votes	Share	Seats	Votes	Share	Seats
Pro-Peace	+608,256	+5.4%	+20	-581,826	-7.8%	-27
Anti-Peace	-350,701	-5.7%	-25	+579,861	+4.7%	+21
all others	+50,646	+0.3%	+5	+308,828	+3.1%	+6
	+308,201	0.0%	0	+306,863	0.0%	0

Source: Sri Lanka Department of Elections

In effect, there was a strong swing towards the UNP in December 2001, and an even stronger swing away from them in April 2004, suggesting that the rise and fall of the UNP-led government, and the subsequent rise and fall of the peace process, reflected a broad shift in voter sympathy in both instances. Indeed, since the island's religious and ethnic minorities, amounting to one-third of the population, are widely supposed to have voted for the UNP or UNP coalition allies in both elections, it is reasonable to infer that the national-level voter swing that generated the anti-incumbent election results in 2001 and 2004 came largely from the majority (Sinhala-Buddhist) community. What explains their significantly shifting allegiance between these two elections? Conventional explanations of this phenomenon suggest that the majority community was deeply ambivalent about the peace process itself, and succumbed to the wave of chauvinist hysteria aroused by Sinhala extremist political parties. I argue instead that although there was a significant segment of Sinhalese society that was reflexively opposed to the peace process, the election verdict of April 2004 reflected a significant economic protest vote against the government's market reforms.

3. The Domestic Corporate-Peace Agenda

The UNP that came to power in December 2001 calling for an immediate cease-fire and peace talks is historically the party of big business, favouring private enterprise, and the de-regulated flow of foreign investment and trade over state intervention. During the 1950s-1970s, the UNP struggled to shed its elitist, pro-business image and expand its electoral base to accommodate the tide of populism and majoritarian nationalism. But despite its most strenuous attempts to erect a façade of religiosity and nativist authenticity, the UNP never fully shed its core social identity as a party of the comprador bourgeoisie, i.e., of the wealthy, westernised, urban social and business elites. And, certainly, it never changed its economic identity, which remained always distinctly in favour of business – and in particular the largest and most internationally connected segments of the business community.

Even through the most genuine attempt at popularising the party in the Premadasa period (1988-93) – which was marked by highly politicised 'outreach' schemes designed to distribute patronage more widely and to mobilise new constituencies of support from rural, lower-caste and lower-class groups – the UNP remained nevertheless the party of choice for big business. It remained ideologically committed to market reforms, foreign investment, privatisation, and private-sector led growth, maintaining an instinctively intimate, hand-in-glove relationship with big business groups, not unlike the British Conservative Party or the U.S. Republican Party. By the 1990s, the UNP came to reflect the interests of the changing material base of the business community towards Export Processing Zones (EPZs), the tourism industry, and garment factories.

In the years preceding their December 2001 election victory, the UNP underwent a considerable internal transformation in opposition that helped it re-connect to the changing material interests and corporate culture of the world of big business. Much of its internal transformation during the late-1990s was synchronous and occurred in close coordination with a parallel transformation in the attitudes and political agenda of the business community, and its changing material relationship to the war. One of the most striking aspects of this relationship is that most of the productive physical assets of Sri Lanka's business community, in terms of factories, tea plantations and tourist hotels, have traditionally been located in the south and west of the island, i.e. in the areas that are dominated by the majority Sinhalese community and which have been relatively unaffected by the war. Under market reforms and globalisation from the late-1970s, the economic structure of Sri Lanka changed considerably to a new economy of garment exports and tourism. Concentrated in this relatively unproblematic south-western part of the island, business experienced rapid growth, even amidst the destruction of years of ongoing civil war. At the same time, the economy of the north-east (which had always been remote and economically unimportant) was rendered even more marginal, remote and desolate due to the concentration of the war in this region.

This geographical segregation of destruction and development began to change by the mid-1990s when the mounting costs of the war actually began to affect the economic prosperity of the south for the first time. Corporate leaders and lobby groups began to voice concerns that the war – funded largely by taxing the private formal sector – was frightening foreign investors, customers and tourists away. But more directly, the LTTE had in the late-1990s initiated a terrorist bombing campaign aimed at economic targets, causing unprecedented destruction to the economic infrastructure in the south for the first time. In January 1996, the LTTE attacked the Central Bank building in Colombo, killing 91 people, injuring over 1,000, and destroying a large part of the financial district. In October 1997, they launched another powerful bomb blast in the Galadari Hotel that again targeted the financial district in central Colombo. By 1999, the LTTE was clearly gaining the upper hand even in the conventional war in the north, and was quickly regaining large tracts of territory that the army had won at great expense over the prior three years.

Having earlier been mostly silent and tacitly supportive of the war, which they tended to view within the confines of a 'law and order' perspective, by the late-1990s business groups were tending to view the war as an expensive indulgence, fought over a remote and economically peripheral province, for reasons that were now receding in importance if not entirely redundant. The increasing frustration of Sri Lanka's business community with the costs of the conflict dove-tailed with a broader sense of unease they felt with the government of President Chandrika Kumaratunga. In contrast to the crisp, authoritarian efficiency of the pro-business UNP, which had been in power from 1977-94, corporate leaders were frustrated and irritated with the inefficiency and lumbering, half-hearted pace of market reforms and private sector economic incentives that followed the 1994 victory of Kumaratunga's left-centre coalition. Through influential business lobby groups, the corporate sector had by the late-1990s united to launch an increasingly public lobbying campaign behind a fairly simple two-point programme (i) an end to the war (ii) revitalising the economy through private sector subsidies and fast-tracked market reforms. Importantly, these two were being increasingly articulated not as separate items, but as mutually complementary and synergistic components of a new national development strategy towards faster private-sector led economic growth.

As the synergistic overlap of peace and unrealised economic opportunity became compelling and urgent to the business community, it was also being adopted by the reformed UNP in opposition, with whom they continued to maintain close social, political, economic and family links. Between 1998 and 2000, the business lobby's stance on the war subtly changed from one of supporting bipartisan cooperation over devolution proposals in 1998, to one of direct talks with the LTTE. Not un-coincidentally, the UNP leader Ranil Wickremasinghe had by December 1998 also begun to advocate direct talks with the LTTE.[8] In the December 1999 presidential elections, Wickremasinghe's position on the ethnic conflict was the most generous ever by a mainstream southern leader: an immediate cease-fire with the LTTE, followed by direct negotiations and the establishment of an interim power-sharing institution in the north-east.[9]

The period December 1999-December 2001 was characterised by a deepening economic, political and military crisis. There were three general elections held in this period amidst the continued disintegration of Kumaratunga's People's Alliance (PA) coalition, the slow collapse of its policy agenda, a severe economic crisis, and a series of grave military setbacks. In early 2000, the LTTE inflicted a serious defeat on the government at the second battle of Elephant Pass, and regained entry into the neck of the Jaffna peninsula. The ensuing parliamentary elections of October 2000 gave Kumaratunga the barest of majorities, and produced a fragile government that depended entirely on the support of petulant coalition members.

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[8] Island, 1 December 1998, 'Ranil tells govt. to accept Prabhakaran's peace offer'.

[9] Wickremasinghe's position on direct talks with the LTTE appears to have crystallised around August-September 1998 when he held discussions with pro-LTTE diaspora organisations and gave an interview to a Jaffna-based Tamil newspaper (see Sunday Times, 6 September 1998, 'Ranil Talks to NY Tamil Sangam').

In July 2001, the LTTE launched a highly successful suicide-commando attack on the Katunayake air force base, which is adjacent to and shares facilities with the country's only international airport. The attack had a devastating economic impact, particularly on tourism and sectors dependent on external trade, due to the imposition of crippling war-related insurance surcharges on air and sea freight. Sri Lanka consequently suffered its first ever period of negative economic growth of –1.4% in 2001 (CBSL 2002), and in the weeks that followed, also suffered the suspension of the payment of the next tranche of its IMF standby facility due to failed performance targets. Overall, between early 1997 and late 2001, the Colombo stock exchange had lost over half its total value, and the business community became increasingly despondent and desperate for change.

In the face of such a sudden and visible economic loss, the logic of resuscitating the failing economy by ending the failing war effort suddenly became far more compelling and urgent. The resulting elections in December 2001 re-energised a new group of 'business for peace' lobby groups who pooled their resources to launch a high-profile media campaign in favour of the UNP's peace agenda. Predictably, the leadership behind the 'business for peace' agenda and the open election lobbying for the UNP was led by those very sectors that were worst hit by the war: tourism, apparel, tea, and import-export. More generally, the peace agenda was supported by the largest, most internationally connected segments of the business community, as characterised, for example, by the members of the blue-chip Ceylon Chamber of Commerce (CCC). Indeed, the CCC itself played a leading role in lobbying to bring the peace/market reform agenda into political reality.

The UNP won a clear victory in the elections of December 2001, and the government that they formed under Ranil Wickremasinghe as prime minister quickly began work on a two-point programme of peace and market reform. Indeed, given the way in which the two were rationalised as contingent upon one another, it could be argued that there was in reality a one-point programme of rapid private-sector led economic growth, of which peace in the north and market reform in the south were simply inter-dependent components (Bastian 2005). Many of the leading cabinet ministers in charge of the peace process, such as G.L. Peiris and Milinda Moragoda, actually headed ministries in charge of economic reform. The government's energetic prosecution of this programme in its first 18 months in power earned it the strong support and approval of the international community, who in a landmark donor conference in June 2003 pledged a record $4.5 billion in aid.

Within weeks of coming to power, the new government began drawing up plans for a more sophisticated and detailed medium to long-term 'post-conflict' economic agenda. The government viewed development not just as an end in itself, but as part of a mutually synergistic strategy whereby development and peace would be mutually reinforcing. Since war was constraining economic growth in key sectors, peace was seen as the key to economic stability, foreign aid, growth and prosperity. In turn, the benefits of the peace dividend and economic growth would create prosperity in the north and south, increase living standards and create rational economic reasons to remain peaceful and prevent a return to war.

Yet another elaboration of the UNP's rationale for peace and economic growth was promoted by one of its most ambitious young stars, Milinda Moragoda, the new minister in charge of privatisation.[10] In his October 2001 Sinhala-language book *Peravadanak*, and in several subsequent newspaper articles and interviews, Moragoda has argued that Sri Lanka's economic future lies in being the gateway to

[10] See for example, his website, www.milinda.org.

India; as an entrepôt metropolis that does for the fast growing southern Indian economy what Hong Kong does for southern China.[11] This role, he warned, was being usurped by Dubai, and Sri Lanka needed to act fast to reclaim it. He went on to elaborate that for Sri Lanka to play this role, a land link to India would be essential. The logical route for such a link would be through Mannar in the war-torn north, and for that, notes Moragoda, and end to the war was a must.[12] Peace was thus envisaged at the highest levels of the UNP and business world not just an end in itself, but as a critical component of an economic strategy in the broad context of positioning Sri Lanka to reap the benefits of globalisation and regional economic integration.

4. The International Community (IC)

The key players in the peace process that kicked off in December 2001 were not just the UNP and big business, but included a substantial external component. Most prominent among them was Norway, which had served as intermediary and neutral facilitator between the two sides, and which organised a ceasefire monitoring mission on the ground, staffed and funded by the Nordic countries. There were also the global and regional powers – the US, India, and China – whose interventions were coloured by the rapidly evolving geopolitical compulsions of the post-9/11 world, and to a lesser extent, by commercial imperatives. There were international donors and international organisations of various sizes and types – the World Bank, Asian Development Bank (ADB), the UN agencies, and the bilateral donors such as the UK, Japan, Canada, and Germany, who had a diverse set of interests in infrastructure, agriculture, poverty, refugee relief, capacity building and market reforms. There were international NGOs and relief agencies specialising in everything from land mine clearance and peace education to human rights, child combatant rehabilitation, and rural livelihoods.

The international community in all of these guises embraced the Ranil Wickremasinghe government and its peace initiative wholeheartedly. The government was not only pursuing an unprecedented peace initiative, but was pro-market, investor-friendly, pro-west, and displayed a managerial efficiency and entrepreneurial energy uncharacteristic of third world democracies. The extent of the donor community's unrestrained excitement with the programme of peace with market reforms comes across in this brief evaluation by the World Bank:

> *Today, Sri Lanka has a great window of opportunity. The United National Front (UNF) Government that came to power in December 2001 with a mandate to secure peace and accelerate economic growth has already embarked on a bold program of peace/reconciliation and a comprehensive set of economic policy/institutional reforms to promote private sector-led growth* (World Bank 2003a).

The peace process was deliberately internationalised by the Ranil Wickremasinghe government, which was itself very IC/donor friendly in the sense that a large number of its leading members, both in terms of cabinet ministers, the kitchen cabinet, and its key mandarins, were cosmopolitan, English-speaking, westernised and western educated, and had cultivated close links abroad. The IC/donors had thus a variety of possible entry points to infiltrate, influence and participate in the highest levels of power. Indeed, the extent of the close match in the agenda and interests of the IC

[11] Daily News, 5 January 2002. 'Peravadanak stimulates discussions by the voting public on wider issues.'
[12] See Moragoda interview Sunday Times, 6 January 2002 'Finding the right economic mix'.

and the UNP government was such that the IC was effectively not just a very close ally, but perhaps even an important element of the structure of power, insinuating its material, cultural and intellectual influence through various levels of the state and civil society.

In the late-1990s, the aid donor community, and particularly the World Bank was, together with the UNP and the Sri Lankan business community, undergoing a transformation in its attitude and practices towards conflict-ridden countries. As with the business community, many donors felt that they could no longer work around the conflict and pretend it did not exist, but would have to address it more directly through their programmes, through policy dialogue with the government, and perhaps even through conditionality (Goodhand 2001, Ofstad 2002). By the end of the 1990s, international development workers increasingly talked of the need for 'mainstreaming conflict sensitivity' into their practice. The World Bank's 2001 internal evaluation audit on Sri Lanka remarked self-critically that the bank's activities needed to be far more directly conflict-sensitive. But in the same breath, the document asserts without any apparent contradiction, the need for such conflict-sensitivity to go hand in hand with market reforms:

> Completion of the structural reform agenda and a resolution of the conflict in the North and the East are the key missing elements for Sri Lanka to accelerate growth and achieve further poverty reduction. Bank assistance should help overcome both these constraints (World Bank 2001: 14).

Indeed, the international component of the peace-with-reforms link descended upon Sri Lanka not through an imposing foreign state-building mission, but through aid donor doctrine and the prioritisation of economic growth above all other objectives. In the years leading up to the 2001 peace process, a succession of documents by the donor community identified war and excessive state involvement in the economy as the key constraints to economic growth. To some extent, this was a matter of tactics – by pointing to the economic impact of the war, the international community was able to use a putatively non-political, technocratic, developmentalist logic to exert pressure and advocate its early termination without appearing to interfere in the government's political agenda. But in terms of its actual materialisation and delivery, the way in which market reforms and peace were woven together owed much to the economistic instrumentalisation of the peace process by the aid donor community. As such, the donor community's increasing frustration with the government was being articulated in very similar terms to that of the country's own business community, which had similarly instrumentalised peace as a component of its own economic agenda. Through policy documents, speeches, and the myriad lobbying mechanisms available to them, both these actors were by 2000 clearly promoting an identical two-item agenda: peace and market reform.

At about this time, the cross-country literature on the economics of post-war reconstruction outside the World Bank was increasingly urging caution on the issue of market reform. Susan Woodward, for example, wrote:

> Sequencing of policy reforms had to be sensitive to the fact that in the early transition from war to peace, governments are fragile and unstable, and can rarely push rapidly on economic reforms (Woodward 2002: 195).

But in Sri Lanka, this is precisely what the donors were consciously and aggressively promoting. In fact, one World Bank document suggested that the fragile situation in the immediate aftermath of Sri Lanka's February 2002 cease-fire provided an ideal 'window of opportunity' to implement 'difficult market reforms' which had proved politically problematic in the past (World Bank 2003a: 16).

The extent of donor dissatisfaction with the Kumaratunga government, and its own internal evolution and new-found willingness to address the conflict issue, was very clearly displayed at the annual aid forum in December 2000. After having supported the government with considerable foreign aid through its early years, the donors now refused to pledge new assistance, demanding instead that the government take concrete steps to end the war and speed up market reforms. The World Bank's 2000 Development Policy Review noted:

> Sri Lanka's future economic and social development will depend not merely on maintaining sound macroeconomic management and accelerating privatization, but more importantly on the country's ability to resolve the on-going conflict and move quickly into implementing key structural reforms to enhance economic growth and reduce poverty. The most difficult long-term challenge is resolving the conflict (World Bank 2000: iii).

In contrast, the donors that attended the next aid forum in June 2002 under the new UNP-led government were very impressed. The World Bank's South Asia region chief Mieko Nishimuzu was actually moved to poetic praise.

> Once in a blue moon, in our development work, there comes a moment when one must put the past behind, look squarely into the future, dream what was thought impossible, and choose "a road less travelled by". Time, to suspend disbelief. Time, to change mindset. Time, to act – and act differently.
>
> In my years at the World Bank, I have been blessed to witness a few such moments. This, ladies and gentlemen, is such a moment, for the sovereign people of Sri Lanka. It is also such a moment for us, Sri Lanka's development partners.

She went on to close her speech with a full recitation of Robert Frost's poem 'The Road Not Taken'.[13]

5. Crisis Overhang

Within three months of taking power, the new government had negotiated a detailed cease-fire agreement with the rebel LTTE, opening the door for further normalisation and direct negotiations. At the same time, they also began drafting a comprehensive medium-term economic growth strategy to be presented to the aid donors. The new government's first task was to resuscitate a standby funding agreement (SBA) with the IMF that had been suspended under the previous government (IMF 2002). They also inherited an economic crisis from the 2000-2001 period, and had to contend with the fiscal hangover from the previous government's pre-election splurge in late-2001.

As a result, the government's economic policy agenda, which remained at a largely conceptual level, took shape and emerged in the course of tackling the pressing economic problems that it inherited, and in negotiating the donor funding that it

[13] Sri Lanka Development Forum 2002 - Closing Remarks. Accessed from World Bank website, http://go.worldbank.org/APZYJ41TY0, August 2006.

desperately needed. The government's immediate target was not only to revive the SBA, but to secure quick approval of the IMF's highly concessional Poverty Reduction and Growth Facility (PRGF). The PRGF also acts as a gatekeeper to further official aid and private capital flows: as the governor of the Central Bank of Sri Lanka explained, it was 'like a character certificate indicating that the country's economic policies were sound and would give confidence to investors.'[14]

The pursuit of the SBA and the PRGF dominated the course of the government's economic policy agenda during its first year in government. The immediate compulsion of restoring macroeconomic stability and the conditionalities required by the IMF to revive the SBA tranche focussed heavily on fiscal austerity measures and expenditure control. But as Susan Woodward observes 'the economic approach and decisions of the IFIs, particularly the IMF, and the political tasks of implementing a peace mission, are often directly in conflict' (Woodward 2002: 194). Indeed, there are grounds to suggest that the implementation of IMF conditionalities was of direct negative consequence to the sustainability of the peace process – although the blame should not be placed entirely on the IMF, for the government was not entirely a reluctant partner in this task.

One of the problems faced by the government in meeting the IMF conditionalities was that the peace dividend was slow in coming. Despite the sharp reduction in security concerns following the ceasefire, there was in reality very little reduction in defence expenditures, of which around 85% consisted of recurrent expenditures, and 71% of wages and salaries alone. Furthermore, the capital expenditure component also remained high from the deferred payments as a result of military hardware orders made before the cease-fire. Since defence expenditure reduction was minimal, the fiscal compression required by the IMF had to come from cutting other areas such as infrastructure and subsidies. As Saman Kelegama correctly argues,

> Fiscal tightening through expenditure restraint therefore occurred at precisely the time when the public finances should have been orientated to building peace. … Over-obsession with fiscal targets therefore proved to be counter-productive in terms of delivering the immediate economic dividend that could have helped the peace progress (Kelegama 2005).

Furthermore, the actual aid disbursements to promote the peace at an early stage were very small. With strict ex-post conditionality, i.e. that aid was conditional on progress in market reforms and the peace process, the government faced a tight situation in 2002-2003. Finally, the uncertainty of the political situation and the peace process restrained large investments by the private sector and did not create the increase in employment that could have benefited poor southern households.

One of the most critical and consequential of the IMF-required fiscal measures taken in 2002 was a hiring freeze which cancelled all existing vacancies in the public service, provincial public service, local authorities, public corporations, and statutory bodies.[15] It immediately affected not only the thousands of aspirants for whom government employment was the traditional route out of rural poverty, but the government's own patronage distribution system. Ministers protested vigorously (but to no avail) that they were no longer able to reward loyalists and constituents.[16] As the UNP's party chairman Malick Samarawickrame explained, 'We had very strict

[14] Sunday Times, 27 April 2003, Financial Section, 'Prayers Answered'.
[15] Ministry of Finance and Planning, Management Service Circular no. 16, 1st October 2002.
[16] Interviews, CR, 2006, JR 2006.

policies, even people associated with the party were not given jobs'.[17] During the UNP government's brief period in power, the public sector workforce shrank by 10.5% – partly because of the vigorous implementation of the hiring freeze, but also because of a voluntary retirement scheme, and the removal of thousands of temporary workers hired in the public sector as a pre-election giveaway by the previous government (CBSL 2005: statistical appendix, Table 60).

There is evidence to suggest that the loss of public sector jobs was offset by a substantial increase in private sector employment in this period. But these jobs are traditionally restricted to either low-income manual labour jobs, which paid less than half that of comparable jobs in the public sector, or to white collar jobs, which due to English language fluency requirements, were typically beyond the reach of the educated rural poor.

In anticipation of the final review of the SBA, which required that the government achieve set targets and demonstrate a certain 'pace of reform' ahead of the PRGF discussions in October, the government had by July 2002 decided that it would fast-track 36 items of legislation through parliament in the month of August.[18] As the subsequent IMF review noted with satisfaction:

> VAT was introduced on August 1, the privatization and banking reform benchmarks were completed by mid August, the Welfare Benefit Law was submitted to parliament and approved on August 26; Cabinet approved the draft Electricity Reform Act which was gazetted on August 16, Cabinet approved amendments and special provisions bills on the Industrial Disputes and the Termination of Employment of Workmens Acts on August 28. Although the electricity and labour market bills have not been presented to parliament, the PM has instructed that they be tabled in Parliament by September 6. [19]

6. Regaining Sri Lanka

By the time negotiations with the LTTE began in September 2002, the government was holding parallel negotiations with the IMF for the PRGF. Following further progress on the peace negotiations with the LTTE in December 2002, the IMF approved a $567 million PRGF/EFF credit in April 2003, and the World Bank simultaneously approved a $125 million Poverty Reduction Strategy Credit (PRSC).[20] Both were based on financing a programme of accelerated reforms of which the key highlights were reforms to labour market regulation, strengthening property rights in land markets, privatising the power and banking sector, and rationalising the civil service. Approval of concessional finance from the IMF/World Bank then opened the gates for the monumental $4.5 billion in further donor aid pledged at the Tokyo donor conference of June 2003.

The make-over of the IMF's Extended Structural Adjustment Facility (ESAF) into the PRGF in 1999 brought into being a new set of standardised procedures and processes that had to be followed. Application for a PRGF loan from the IMF requires recipient countries to prepare and submit a detailed PRSP. The PRSP approach was introduced in 1999 largely in response to two widespread criticisms

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[17] Interview, MS, 2006.
[18] Daily News, 19 July 2002. '36 Laws to be Passed in August, September'.
[19] Statement by the IMF staff rep, 3 September 2002.
[20] World Bank (2003b).

that had emerged from the market reform-based lending programmes of the IMF and World Bank. Firstly, the recipient countries and governments were being forced to implement top-down market reform policies designed and imposed from Washington and it was thought that this lack of 'ownership' was a major reason why the programmes were often not fully or effectively implemented. Secondly, these reforms had negative social consequences, and were not sufficiently sensitive to poverty alleviation. Under the PRGF/PRSP framework, concessional lending to the poorest countries was refocused on poverty alleviation, with the economic framework to be authored by the recipient countries themselves and based on widespread internal consultations. As the IMF describes it,

> the principle of broad public participation and greater country ownership is central to the PRGF … PRGF-supported programs reflect more closely each country's poverty reduction and growth priorities (IMF 2006).

The new PRSP approach required a much more comprehensive and technically rigorous approach to poverty analysis. It also required that the strategy to address poverty be 'country-driven, promoting broad based participation of civil society' (IMF 2005). With these stated aims in mind, the reality of the PRSP formulation process in Sri Lanka is instructive, not just to understand how it contributed to destabilising the peace agenda, but also as a case-study of how its key design features on process and content were so transparently circumvented and undermined.

Between March and December 2002, the UNP-led government commissioned the drafting of a comprehensive economic master-plan called *Regaining Sri Lanka* (RSL) (GOSL 2002). As with the contents of the cease-fire agreement or the progress with the peace process, very little information about this document was divulged to the public, parliament, or even many members of the government. This document was ultimately submitted to the IMF and World Bank in December 2002 as the PRSP.

When the PRSP document was eventually released in the domestic realm, which occurred only after it was sent to the World Bank and IMF, it quickly became very controversial. Through the rest of the life of the government, and even after that, opposition politicians, trade unionists and civil society activists singled out the RSL as a doctrinaire manual of market reformist excess. It was viewed as emblematic of the secretive and non-inclusive nature of the government's policy formulation process, and its complete subservience to the agenda of the private sector and the donors. In itself, there is little to dispute in this characterisation, and indeed, there is much more that is not widely known.

One of the most problematic issues with the RSL document was its utter lack of public ownership. The highly secretive nature of its formulation was not accidental but a product of conscious design. Despite the largely donor-driven rhetoric of inclusion, participation and consultation, the equally donor-funded processes of sponsoring the formulation and implementation of market reform policies requires them to be de-politicised, technocratic, and driven by expert knowledge. The PRSP is explicitly required to incorporate a certain extent of public consultation, but there is evidence to suggest that the World Bank staff turned a blind eye to this requirement.

The process of drafting the RSL involved a substantial degree of transparent, formally organised participation from 18 sectoral committees, which apart from a few academics and technical experts, were comprised almost entirely of business executives. As the then chairman of the island's premier corporate lobby group, the Ceylon Chamber of Commerce, described,

> There was heavy private sector involvement and input in RSL. There were a number of committees bringing in numerous industry stakeholders. There was a significant degree of input. … You just asked for something and it was given. … When we saw RSL, we thought our dreams are coming true.[21]

The joint Bank-Fund review of the PRGF and PRSC enthusiastically described the RSL as:

> a strong and aggressive proposal to remove the existing policy induced and structural constraints that inhibit private sector activity in the way of changing the role of the state (IMF 2003).

The RSL laid out a comprehensive medium-term framework of infrastructure construction, privatisation, land and labour market reforms, and a private sector-led growth strategy. Jeyaratne claimed that, 'Large parts of the RSL document were plucked straight out of our recommendations'[22] and indeed, the extent of unmoderated corporate sector input reads clearly throughout the document. But given the new requirements under the PRGF/PRSP process, many of these provisions have had to be somewhat awkwardly reworded as contributions towards poverty alleviation. The final document that was actually submitted to the donors in December 2002 involved a considerable amount of 'cut and paste' artistry on the part of the RSL staff to transform what was an exclusively private-sector influenced growth and reform strategy into something that could reasonably be represented as a poverty reduction strategy based on widespread consultation. This was not a task that they appeared to enjoy, and the lead author of the RSL confided that he found the PRSP exercise a 'bureaucratic, wasteful process' and that 'one of the problems with the PRSP process is the consultative requirement.'[23]

The RSL was eventually transformed into a PRSP by grafting onto it an earlier poverty reduction strategy document developed by the previous government.[24] This earlier document, which contained the requisite section on poverty analytics, also had the benefit of having been put through some measure of consultation – although this too consisted largely of soliciting feedback on completed drafts from technical experts and line ministry officials. On two occasions, this early poverty analysis document was presented to a group of NGOs and CBOs for input (GOSL 2002: Annex 1) – and it is largely on the basis of this highly limited and formalistic exercise that its distant descendant, the final RSL-turned PRSP document, was credited with having undergone an acceptable measure of consultation. The main body of the RSL itself, which included the main reform and privatisation programme, did not undergo any consultation whatsoever outside of the aid donors, the business executives who helped frame it, and the economic sub-committee of cabinet.

But the government was not alone in this act of subterfuge: the World Bank and IMF staff appear to have wilfully cooperated and exaggerated the extent of consultation to the point of complete misrepresentation. The joint WB-IMF review of the PRSP at the approval phase in March 2003 incredibly found:

[21] Interview, CJ 2006. (His emphasis noted).
[22] Interview, CJ 2006.
[23] Interview, JR, 2006.
[24] Interviews with MS, JR, SF (all 2006).

> The extent of consultation that is embodied in Sri Lanka's PRSP 'Regaining Sri Lanka' is commendable and is in fact one of the strengths of the document. A large number of stakeholders, including the government, academia, research organizations, non-government and community organizations, the private sector, trade unions, and donors were consulted at various stages of the document's preparation (IMF 2003).

Similarly, the World Bank's 2003 Country Assistance Strategy for Sri Lanka, written in the immediate aftermath of the PRGF approval, makes several quite inexplicable references to the 'broad', 'widespread', and 'island-wide' nature of the 'stakeholder consultations':

> During the past four years, the administration has engaged in broad stakeholder consultations to reach consensus on a medium to long term strategy for faster and sustained economic development and poverty reduction. … The island-wide consultative process also mobilized views of key stakeholders … (World Bank 2003a: 11).

The real reasons behind this very misleading evaluation are unlikely ever to emerge, and one can only speculate as to how and at what level it might have been encouraged and tolerated. It is only two years later, in the World Bank's first review of the PRSP, written after the substantial collapse of the reform agenda that a more considered evaluation of this issue emerges. In a remarkable *volte face* that makes no mention of its past assessment, the 2005 review found that there was indeed inadequate consultation, and that this might have been a critical cause of its failure.

> In general, program implementation could have benefited from wider and deeper consultations with stakeholders, especially civil society and within government (World Bank 2005: 12).

Given that the World Bank sponsored the drafting of virtually the entire PRSP, including the RSL and the previous poverty analytics exercise, and that World Bank representatives were present for most of the supposed consultative exercises, they cannot have been unaware of the reality. Furthermore, on the eve of the PRGF approval in February 2003, a coalition of 72 trade unions and civil society groups addressed a letter to the IMF, World Bank, Asian Development Bank and UNDP, charging:

> We categorically state that the Government of Sri Lanka has failed to carry out even this minimal consultation with the people, and that the proposals have been worked out in total isolation. … We, acting on behalf of the people, totally reject the proposals contained in the PRSP. [25]

This organisation subsequently had several exchanges with the IMF and World Bank in 2002 and 2003, specifically on the issue of consultation, and was even provided with a list of the NGOs purported to have been consulted. Leaving aside the issue of the representative character of these NGOs, it emerged upon subsequent investigation that their participation in these sessions was quite perfunctory, i.e., it was limited to commenting on a finalised draft, to which no further changes could be made.

[25] Statement by the Alliance for the Protection of National Resources and Human Rights (ANRHR), 18 February 2003.

But beyond the issue of subterfuge and the ethical questions it raises over the actions the World Bank and IMF staff, the content and formulation of the RSL document were highly problematic. By drafting such a putatively technocratic document, insulated from populist pressures or even from contact and feedback from ruling party members and government ministers, the document came to reflect a very narrowly held economic vision. By seeking to depoliticise economic policy, it effectively lacked the political buy-in or ownership of any domestic political constituency except the corporate sector. As the general secretary of one of the largest trade union federations described:

> There were no consultations with the trade unions. The UNP was more disciplined, but it was not transparent. There was no dialogue with stakeholders, so everyone was suspicious. [26]

The secrecy behind its formulation left the document exposed to criticism from a wide number of social and political constituencies, with very few people left capable of, or inclined to, defend it. As Saman Kelegama describes:

> Under the grand reform programme there was no effective strategy to buy-off opposition to reforms other than the assumption that foreign aid inflows will cushion the adjustment costs. With the mighty hurry to implement reform, the government basically played into the hands of the opponents of reforms. Thus electricity, railway, health reforms, all backfired without any achievements (Kelegama 2006: 42-43).

A few members of the UNP government and party apparatus (when interviewed in 2006, two years after they lost power), grudgingly admitted that they should perhaps have 'done something for the poor' for instrumental reasons – i.e., in order to preserve the sustainability of the reforms. But most, including the former prime minister, Ranil Wickremasinghe, were unwilling to concede that the peace process and economic reforms were mutually incompatible agendas. The two processes were seen as synergistic, and mutually dependent on each other for success.

The World Bank actually went further, to assert – without any justification, and in the face of their evidence to the contrary in other countries – that the fragile post-conflict scenario actually presented a unique window of opportunity to implement 'difficult' market reforms. 'There are good prospects for addressing key economic and social reforms in such a situation even those that have proven difficult in the past' (World Bank 2003a: 16). But just two years later, the World Bank's post-hoc review of the PRSC came close to reversing this position. Without any hint of self-criticism or reference to their previous position, they suggested instead that difficult reforms should perhaps have been implemented more gradually and sequenced better:

> The past experience also suggests that more attention needs to be given to the sequencing of reforms. The PRSC program was perhaps too overloaded with "politically-sensitive" reforms, i.e., public sector, welfare, labor and land reforms, and a more phased approach may have been more manageable (World Bank 2005: 14).

This unusual and unjustified optimism that difficult market reforms would succeed in the midst of an equally difficult peace process was eventually tempered only by the

[26] Interview, LD, 2007.

considerably different reality that transpired – of an election defeat for the UNP, and a failed reform agenda that dragged the peace process down with it. The election campaign of March-April 2004 focussed considerably on the issue of peace, and it is frequently interpreted as a resounding verdict by the Sinhala-Buddhist majority against the peace process. But the sparse evidence that is available suggests otherwise. Sinhala-Buddhist rural voters were well aware of the fact that a defeat for the UNP would inevitably be a setback for the peace process, a situation to which they were not indifferent – particularly because armed forces personnel are overwhelmingly recruited from the rural Sinhala-Buddhist poor, and a return to war would once again have put their sons' lives at risk.

Reporters sent to cover voter sentiment in rural districts frequently found that the public sector hiring freeze and the removal of the fertiliser subsidy were the two most important issues raised. 'No one has got jobs in the past two years', said one respondent from Ratnapura district.[27] At the same time, they were not unappreciative of the peace process, and given that many had close relatives in the armed forces, reported that they were 'happy to be alive'. Residents of the southern districts of Hambantota, Matara and Galle, which voted overwhelmingly against the UNP, similarly complained that 'the government has done little recruiting in the past two years', and that in a difficult agricultural year, the cost of fertilisers had more than doubled.[28] Emblematic of the dilemma facing the majority community was this plea from a village voter in a border district of Anuradhapura prone to attack by the LTTE: 'We don't want another war. But we also want our economic problems solved.'[29]

In other words, there was widespread relief and appreciation of the benefits of the peace process, and these voters did not lightly choose to bring war back upon themselves. But the UNP's own agenda of linking peace with reforms forced many who were supportive of peace to vote against it. This is not to deny the existence of a considerable protest vote against the UNP's handling of the peace process, and the presence of a radical Sinhala nationalist constituency which opposed the peace process on principle and voted against it from the very beginning. But this constituency is actually quite small, and has only sustained political momentum and electoral strength when fortified by and conjoined to a populist economic protest agenda. In the April 2004 elections, the UNP provided exactly such an agenda. Having fused peace to market reform, the relatively small opposition to the peace process was magnified and made electorally viable by a new and growing opposition to the market reform agenda.

7. Conclusions

In this paper, I have argued that Sri Lanka's peace agenda in the 2001-2004 period had its origins in a new coalition between domestic corporate lobby groups and international aid donors. Both of these influential actors had separately ideologised the necessity of pursuing an agenda of peace with market reforms. The embeddedness of the peace process within such an economic rationale and the social constituency of its inspiration and sponsorship had important consequences for its sustainability. The government's heavily market-reform laden economic agenda enjoyed a very narrow social constituency of support; and indeed, generated considerable opposition and hostility. In addition, the government's simultaneous pursuit of fiscal austerity to secure desperately needed concessionary financing from the IMF meant that not only was there very little in the way of a peace dividend to

[27] Sunday Times, 21 March 2004, 'Burdened by Life, but Happy to be Alive'.
[28] Sunday Times, 7 March 2004, 'Which Way South'.
[29] Sunday Times, 29 February 2004, 'Reaping Votes on Farmers Woes'.

distribute, but there were instead cutbacks on subsidies and employment opportunities that disproportionately affected the rural Sinhalese poor. The inherent unpopularity of this economic agenda was compounded by the complete absence of consultation, much less participation in its formulation, beyond foreign donor agency functionaries and local corporate executives. Not surprisingly, the government was faced with an increasingly vigorous opposition to the reforms from a variety of different social constituencies.

It is of course impossible to decipher the precise individual voter calculus that led to the UNP's election defeat in April 2004. But evidence presented in this paper suggests that the majority community did not blithely vote for war, and that a considerable component of the anti-UNP vote was on economic grounds. As one veteran trade unionist described:

> [on the peace process], even the left was praising [then Prime Minister] Ranil. But his dealings with the west [on the Iraq war], the market economy, the absence of any social component to the reforms brought him down. Ranil lost the people because of the reforms.[30]

[30] Interview, TR 2007.

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