

Sri Lanka

Status Index (Democracy: 2.8 / Market economy: 3.4)		6.2	Management Index		5.8
System of government	Semi-presidential democracy		Population	18.8 mill.	
Voter turnout	-		GDP p. c. (\$, PPP)	3,180	
Women in Parliament	4.4 %		Unemployment rate	7.8 % (2000)	
Population growth^a	1.3 %		HDI	0.730	
Largest ethnic minority	12.6 %		UN Education Index	0.82	
			Gini Index	34.4 (1995)	
Data for 2001 – if not indicated otherwise. ^{a)} Annual growth between 1975 and 2001. Source: UN Human Development Report 2003.					

1. Introduction

The period under study includes the re-election of President Kumaratunga in the ahead-of-schedule presidential elections of 1999. She immediately took advantage of this opportunity to resume her project for a federal peace solution to the country's ethnic conflict, and to ask Norway to mediate between the combatants. The period also includes the somewhat laborious efforts to reach a consensus with the opposition about the constitutional changes needed for a federal solution. Third, there was a further escalation of the military conflict between Tamil rebel organizations (mainly the LTTE) and the Sri Lankan military, with neither side able to achieve a decisive victory. But slowly rising popular pressure for a peaceful solution and increasing international condemnation of the LTTE have brought about a cease-fire and subsequent peace negotiations.

The latter were facilitated by the election victory of the People's Alliance, which is now willing to compromise, and by announced international support. Yet the "cohabitation" of a president and government belonging to different camps has impeded the process. Economically, the period was characterized by ongoing market-oriented reforms (starting from an already-high level) and also by critical exacerbations of budgetary and current-account deficits, along with flagging economic vitality.

2. History and characteristics of transformation

Economic and political transformation in Sri Lanka has proceeded with a stark time lag. General, free and fair elections have existed since 1931 under the British colonial administration, which left Ceylon a democratic state endowed with

British traits and with local gentleman-politicians socialized under this pattern. These actors initially treated their legacy with prudent caution, creating a pluralistic constitution that guaranteed sufficient protection for the Tamil minority, which had been educationally favored under the British.

To be sure, the opposition soon mobilized the Sinhalese majority of the population to revise the pluralistic nature of the state, enforcing *de facto* monolingualism in government operations (1956), nationalizing the Christian schools, making Buddhism the state religion under the next constitution (1971) and later also impeding university access for Tamils. These actions laid the foundation for the political radicalization of the Tamils and subsequent civil war. The election victory of the conservative UNP in 1977 brought the next constitution, which established a semi-presidential system and called for a limited decentralization of the unitary state. This was too late to allay the escalating ethnic conflict, which the government attempted to stop initially with exceptional laws and the massive use of the military against the increasingly effective Tamil rebel groups, and later with the requested intervention of an Indian peacekeeping force (1987) and the offer of quasi-federal solutions (establishment of provincial councils) to the minority.

The democratic legacy was further damaged by a constitutionally questionable extension of the term of office of the elected Parliament, manipulation of election dates, a near-permanent imposition of a state of emergency and—primarily against the party of rebelling Sinhalese youths, which again grew violent toward the end of the 1980s—the use of paramilitary associations in the interior and a systematic disregard for human rights. Increasing exhaustion of the parties to the civil war (the military and LTTE) led after 11 years of hostilities to the first formal cease-fire under the left-wing People's Alliance coalition, which had been in power since 1994. After a few rounds of negotiations, the LTTE terminated the truce unilaterally.

In subsequent years the government pursued a two-pronged strategy: working out a federal constitutional solution while at the same time intensifying military pressure on the Tamil rebels. The former plan collapsed against the opposition's resistance, motivated by election tactics; the latter was defeated by the fighting strength of the LTTE. The UNP's electoral victory at the end of 2001, international condemnation of the LTTE and Norwegian mediation led in 2002 to a cease-fire agreement that has held to date, giving way to peace negotiations (in Thailand and Norway).

Sri Lanka inherited from the British a relatively functional plantation economy and a relatively highly developed social system financed from that economy, but also a comparatively undynamic agricultural sector and poorly diversified industry. The plantations were additionally used more and more to finance a state-economy industrial sector replacing imports, and to expand irrigated agriculture.

Ultimately they were nationalized. This strategy was associated with increasing current account deficits and, concomitantly, growth in import restrictions, weak exports and low job growth. The latter, in combination with a large output of well-educated young people, led to the first uprising of youths in 1971.

In 1997 the conservative government rang in a change, devalued the rupee, expanded tools to promote exports, established free production zones, eliminated most price controls, and set up a massive program to expand irrigation and increase electric production. This achieved a substantial stimulation of the economy, but at the cost of increasing debt. Yet despite the intensifying civil war, the reforms were soon continued nationwide, privatization was intensified, the civil service was reformed, and traffic in goods and capital with other countries was liberalized further. Nor was this course interrupted by the assumption of power by the former socialist partners of the People's Alliance.

Sri Lanka was incorrectly viewed as a country that had, early on, pursued a strategy oriented to basic needs. Free State education and health services, along with subsidies for goods to cover basic needs, had indeed been introduced early, but were by no means concentrated on the poorer segment of the population. Additionally, state benefits were unbalanced against basic services. Nevertheless, they sustainably improved social indicators to a level that substantially exceeded, and still exceeds, the country's level of economic development.

3. Examination of criteria for democracy and a market economy

3.1 Democracy

In the past few years, Sri Lanka has made progress in partially restoring its once relatively exemplary democratic regime. Deficiencies are especially evident in the rule of law, in respecting human rights and civil rights, and in asserting the state monopoly of violence.

3.1.1 Political organization

(1) *Stateness*: There are quite definitely problems with state identity in Sri Lanka. These pertain first of all to the question of a sense of belonging to the nation, which at least some of Sri Lanka's Tamils would answer in the negative—at least until a true federal revision of the state's structure has taken place. De facto, not all citizens have the same civil rights. Rights have been restricted in the regions of conflict, and with regard to Tamil youths in general. There is no clear separation of church and state, as witnessed by Buddhism's status as the state religion; monastic orders are supported by the state, as are Buddhist universities, and have been able to torpedo the peace process for a long time.

Although the constitution unequivocally establishes civil control over the military, during the civil war and because of numerous exceptional laws, not to mention through the establishment of a special task force and militias, the military has gained extensive independence and has long promoted the militarization of the ethnic conflict. Additionally there are extra-constitutional private armies controlled by politicians, which armies have taken the place of the government prosecution of criminals, and a proliferation of ownership of weapons in the country. Administrative efficiency is not in the best shape. The civil service remains immeasurably swollen and serves as a buffer for the job market. Recruitment is largely on the basis of political affinities or patronage.

(2) *Political participation:* Since independence, Sri Lanka has had comparatively a very high voter turnout (usually above 80 %), which has suffered little even from boycott initiatives that threatened violence. Several times a more-or-less peaceful transfer of power has taken place by way of elections, which themselves were commonly not especially peaceful and were held on dates manipulated by the government or even suspended. Candidates are still at risk of becoming the victims of political plots in both the Tamil regions and the southern part of the country, though this risk is declining.

Since the 1970s, the media have been under de facto state control, undermining their efficacy. Critical reports of government actions, corruption and the like are rare. Today, half of the newspapers are under government control, and the remainders are under the control of the opposition. Censorship has repeatedly been imposed on domestic and foreign journalists, primarily in connection with the civil war. There have additionally been rather frequent physical attacks on opposition journalists.

(3) *Rule of law:* There has also been backsliding since independence on the separation of powers. The introduction of the semi-presidential system in 1977 resulted in considerable centralization of power and a dominant executive branch. Parliament was degraded to a rubber-stamp organization, and representatives were forced to sign undated letters of resignation. This situation was further reinforced when the president served as leader of the majority party. The situation has improved since the “cohabitation” period began (2001). Separation of powers is further restricted by the fact that half the parliamentary delegates also hold ministerial offices, and thus, so to speak, wear two hats at once.

The independence of the judiciary has been eroding roughly since the constitutional reform of 1977. A two-thirds majority in Parliament can nullify a Supreme Court decision on the constitutionality of laws. This court has furthermore been packed with partisans of the government, and the judges sworn in under the previous constitution were sent into retirement. The president also has the power to appoint special investigative commissions whose

recommendations the judiciary cannot question. Intimidation of lower-level judges has become routine.

The level of corruption is rather moderate on the whole, but substantial in procurement and state transfers. The entire administration, however, is subject to massive encroachment and intervention from party politics.

Concern for human rights suffered significantly in the civil war. After 1983, the security forces were equipped with exceptional permits and special powers. The northern and eastern parts of the country were under states of emergency, which were renewed monthly. Additionally, a special task force was set up with little control or discipline (made up of unemployed youths who had been Promised Land), as were militias in colonies of new settlers. In combination with the political brutalization that takes place in civil wars in any case, these exceptional procedures explain the massive scope of violations of human rights, torture and the disappearance of individuals under suspicion.

Moreover, the activities of international human rights organizations were suppressed and reported violations of human rights by subsequently established national commissions incurred no consequences.

3.1.2 Political patterns of behavior and attitudes

(1) *Institutional stability*: With the above limitations on the rule of law, insufficient respect for human rights and violent conflicts, democratic institutions nevertheless were somewhat stable in the lead-up to a threatened electoral victory by the opposition. The governing coalition's majority remained weak and unstable, unable to achieve the adoption of farther-reaching plans for ethnic pacification. During the "cohabitation" phase, there has been an additional stalemating effect from competing attempts to gain the upper hand by the president and a government loyal to a different political party. In social terms, democratic procedures are the only ones that confer legitimacy. No one questions them rhetorically, but in practice they are sometimes subverted. Voter turnout is high; voters are even willing to accept considerable risk in order to cast their votes.

(2) *Political and social integration*: Sri Lanka has a relatively stable but extensively splintered party system, with most of the splintering concentrated in the leftist and Tamil parties. Party polarization is less than the revolutionary party labels would lead one to assume, but on the ethnic question it is still considerable. The population's participation in parties is high, but no precise figures are available. Party discipline is moderate. Tendencies to erosion are accordingly high, especially among the smaller parties.

Union organization is also high (around 45 %). Unions are organized within individual businesses, and are usually collateral organizations of the political parties (except for the plantation unions, which mutated into parties themselves). Unions' freedom of movement in the public sector is limited. Nevertheless, the level of labor conflicts is more than negligible. Business associations are comparatively effective, and support the policy of reform and reconciliation. There is additionally a broad range of NGOs working toward social and peace policies.

3.2 Market economy

Today Sri Lanka is an economy that works largely according to market-economy principles. Transformation deficiencies still exist in the financial sector, in the reform of the civil service and in the reduction of excessive budget deficits.

3.2.1 Level of socioeconomic development

The key indicators show a comparatively high level of development, measured against the country's state of economic development. The Human Development Index is considerably higher than that for comparable countries, although the gap is tending to narrow. There is hardly any fundamental social exclusion on the basis of education or gender-specific factors. But absolute poverty is widespread, and presumably increased even further in the early 1990s (to 25 % of the population), though it is concentrated in certain provinces that were already the worst-supplied with a public social infrastructure.

This troubling situation has been exacerbated by the lack of improvement in the distribution of income and wealth, and most especially by the consequences of the civil war in the North and East, including internal refugees. According to data that are not entirely comparable, absolute poverty was supposedly declining again at the end of the 1990s. It is concentrated in the agricultural sector (including the plantations), and among those with little education.

Unemployment makes only a slight contribution to poverty, since it is mostly well-educated workers from better-off families that are unemployed for more prolonged periods.

3.2.2 Market structures and competition

The foundations of market economy-based competition are safely assured. The once vast density of state regulations has been thinned, and discrimination against foreign investment has been entirely eliminated. There are still particular

deficiencies in liberalizing labor and land laws, setting prices for public services, and the commercialization of state enterprises. Foreign trade has been largely deregulated. Customs duties were recently reduced to two standard rates (10 % and 25 %).

A free-trade agreement was recently signed with India, under which 300 products can already be imported duty-free. Overall, Sri Lanka has the freest trading system in the region. Similar considerations apply for the investment system, which has been standardized and offers almost too many incentives for foreign investment.

Bank supervision was reinforced in 1998–1999, reserve requirements were reduced, and a market for longer-term government bonds is evolving. The government has signed performance contracts with both state banks, which still dominate the market and have high mediation costs. They hold a large number of irrecoverable debts (15 % to 20 % of total receivables), although they have already been recapitalized twice. The state insurance company accounts for more than 70 % of domestic insurance business. The two largest pension funds are publicly administered and make only limited funds available to the private sector. Interest rates were reduced significantly in 2001, but still remain quite high in real terms. The principal reasons are a large fiscal deficit and the irrecoverable debts.

3.2.3 Stability of Currency and Prices

A consistent foreign-exchange and monetary policy was pursued during the period under study, and thus the former high rates of inflation have dropped to quite low levels, despite a massive budget deficit and a lesser balance-of-payments deficit. The delayed adjustment of public prices, the expansion of state employment, the economic downswing and large defense expenditures pushed balance-of-payments deficits to crisis levels until 2001. Currency reserves dropped to critical lows. But the adjustment program agreed upon with the IMF has already brought improvements. Foreign debt is nominally considerable, but because of the concessive nature of the assumed debts, debt service poses little problem.

3.2.4 Private property

Property rights and the acquisition of property are adequately guaranteed in the industrial and service sectors. The situation in agriculture is different; 80 % of agricultural land belongs to the state, but most is leased to private farmers. Their land rights are poorly defined. Some land cannot be sold. The land registry office is understaffed. The result is a considerable restriction on mobility. Land rights are now to be reformed, and restrictions on sales and leases are to be eliminated.

Privatization of former state enterprises has advanced well. An independent authority has managed the privatization of plantations, parts of Air Lanka, a steel corporation, hotels, agricultural corporations and more. The government has reaped substantial revenues from privatization. A slowdown has been evident since 1999. The restructuring of the three largest state enterprises (bus transportation, electricity production and cooperatives), which are heavily in debt and running severe deficits, has not advanced as it should.

Labor laws are all-inclusive and rigid. Dismissals are practically impossible in companies with more than 15 employees. Wages in the formal sector of the economy are comparatively high. In the civil service (for jobs with low qualifications) they are above those in the private economy. All this has encouraged a segmentation of the labor market and reduced employment.

3.2.5 Welfare regime

Traditionally, Sri Lanka has had a clearly progressive, nationwide system for social services. There is good reason why social indicators are still well above those for comparable countries. Add to these factors the early introduction of food subsidies, which were transformed into food brands at the end of the 1970s, and several programs (for both investment and consumption) to reduce poverty.

Yet this historical legacy has been exposed to a certain degree of erosion. One reason: The allocation of funds has stagnated in relative terms, while health care, for example, has grown more and more expensive (in this case, because of the sharp epidemiological transition to degenerative diseases). Similar considerations apply to the educational system: Basic education is practically universal, and there is no gender differentiation in access to education, yet expenditures are insufficient to expand the system of higher education or to improve the quality of vocational training.

For political reasons, poverty programs have always had far too many beneficiaries (usually half the population), and the distribution of resources has been heavily influenced by politics. The poor themselves have not participated in organizing the programs. Accordingly, there is little left over for the truly needy (widows, war orphans, etc.).

3.2.6 Strength of the economy

Despite the civil war, the Sri Lankan economy grew 5 % per year from 1990 to 2000, due to dynamic exports (of raw materials and manufactures) and considerable foreign investment (as well as transfers from projects for developmental cooperation), together with a rather high capital-spending ratio

(usually 25 % or more) and a market-friendly economic policy combined with moderate inflation. At the beginning of the millennium, the situation began to deteriorate substantially due to the worldwide recession, drought and dwindling tourism. An economic downturn of 1.4 % occurred in 2001. But the recession also caused imports to decline greatly, thus reducing the current account deficit. The crisis demonstrated that the Sri Lankan economy remains highly vulnerable, especially in the context of the ongoing civil war.

3.2.7 Sustainability

Environmental degradation in Sri Lanka has reached serious levels. In the country, deforestation, soil erosion, the management of reserves and the use of firewood for cooking have been the chief culprits. There have been adverse consequences for biodiversity, water purity and preservation of coral reefs. Water consumption is immense, because only a very limited proportion of the production costs are passed on to the farmers. Consequently fields often lie under water, become salinated and turn to swamp. Natural forest has shrunk to mere residues. Environmental damage is thought to total 2.5 % of GDP each year. The government has now presented a comprehensive plan for environmental action and designated large areas as reserves.

4. Trend

(1) *Democracy*: The civil war has been a major obstacle to the consolidation of democracy. But even before the cease-fire, the government was at last taking serious steps toward restoring ethnic balance. Particularly noteworthy are its presented program to federalize the country, which goes far beyond previous proposals, but could not be implemented because of resistance from the opposition. There is also a new language program for the schools, providing for bilingual education (since the beginning of 2000).

Additionally, the human rights situation has improved in the northern and eastern parts of the country as the military has taken an emphatically more circumspect approach. Around two-thirds of the population that had fled have already been able to return home. But military trespasses against civilians were still in evidence, as were arbitrary arrests. The state of emergency expired in July 2002, but the anti-terrorism act continues to be applied. Censorship has been relaxed, but reporting on the war still faces obstacles.

(2) *Market economy*: The fundamental developmental indicators show a slight improvement in an already rather high level of development during the period under examination. Despite political instability and civil war, growth was

astonishingly high in the 1990s (3.9 % per capita per year), although it dropped significantly in 2000–2001.

The distribution of income and wealth remained virtually unchanged. The institutional environment for market-economy action has improved further, but at a slower pace due to political instability. The standby agreement with the IMF and the prospect of an end to the civil war raises the possibility for a number of extensive reforms that (assuming they are implemented) would make Sri Lanka a very free country economically.

Table: Development of socioeconomic indicators of modernization

	HDI	GDI	GDP index	UN Education Index	Political representation of women	GDP per capita (\$, PPP)
1998	0.733	0.727	0.57	0.83	4.9	2,979
2001	0.730	0.726	0.58	0.82	4.4	3,180

Sources: UNDP, Human Development Report, 2000, 2003.

Table: Development of macroeconomic fundamentals (1998-2002)

	1998	1999	2000	2001	2002 (P)
Growth of GDP in %	4.7	4.3	6.0	-1.4	3.1
Export growth in %	-2.8	8.6	19.9	-12.7	5.1
Import growth in %	-35.5	28.4	34.0	-12.1	7.8
Inflation in % (CPI)	9.4	4.7	6.2	14.2	9.6
Unemployment in %	9.2	8.9	7.6	7.8	8.5
Budget deficit in % of GDP	-9.2	-7.5	-9.9	-10.9	8.9
Current account deficit in \$ m	-225	-563	-1066	-272	-467

Sources: Central Bank of Sri Lanka, Annual Report 2001, Colombo, 2002 and *ibid.*, Recent Economic Developments, Colombo, Nov. 2002.

5. Transformation management

5.1 Level of difficulty

The high level of social development, a comparatively high level of education and market-oriented policies since 1977, together with their effects, have been somewhat able to cushion the country's massive transformation problems. These problems are rooted in the intensifying ethnic conflict, which in turn was a consequence of competitive populist mobilization under democracy. The government has had to contend with this legacy, an increasingly less peace-minded opponent (the extremely well-equipped and motivated LTTE), violence-prone youths in the South, a rather unfortunately constituted system of government that offered the opposition little incentive to cooperate, and several other less severe impediments. The transformation problems can be categorized as rather substantial.

International conditions have facilitated political transformation (international condemnation of the LTTE, a change of mood after the September 11 attacks). Additionally, an able mediator has become available in the person of the former Norwegian foreign minister. Add to this the growing internal pressure from civil society (especially the business segment) as a mover toward a peaceful solution. Economically, the environmental conditions for transformation in Sri Lanka unquestionably deteriorated during the period under study. But given that reforms are already far advanced, the difficulties should nevertheless be considered only moderate.

5.2 Reliable pursuit of goals

Reliable pursuit of goals of the economic transformation was long lacking during the period under study. In the run-up to various elections, the usual populism was in evidence, reflected in the postponement of necessary price adjustments, massive wage increases in the civil service (by 21 %), the deceleration of the privatization program and an overflowing budget deficit. The latter was of course also a result of escalating defense expenses. Structural reforms failed to materialize in key segments. The 2001 draft budget and the subsequent standby agreement with the IMF made fundamental changes in the situation, although the crisis conditions hardly left the government an alternative.

The new, strict budget entailed free-floating the currency, postponing non-priority expenditures, introducing a broad-based value-added tax, simplifying the tax system and imposing a hiring freeze in the public sector. A complete reform of labor law and the reduction of over-regulation for private investment have been promised. Public prices were adjusted in spring 2002. The accord with the IMF is

thus likely to provide a mighty impetus for further reforms and create sufficient reliability of expectations for social actors.

5.3 Effective use of resources

At least until recently, the government has not made especially effective use of available staff and financial resources for transformation. Staffing in the public sector had grown severely swollen, and staffs in state enterprises and agencies grew phenomenally, even as the amount of work shrank. Together with a corresponding rise in defense expenses, budget deficits got completely out of hand, internal debt rose at 18 % per year, and the state quite openly displaced private investment. Otherwise, because of escalating ongoing expenses, the state was hardly able to invest at all. The use of resources for social-policy purposes was also ineffective. Losses through inefficiency in the poverty programs were massive, and the distribution of benefits was highly politicized and low in participation. Finally, one might also wonder whether resources were used effectively in the civil war. That resources were not used well, actually, is suggested by the failure to defeat a far smaller opponent, along with high desertion rates.

Almost all of this is now supposed to be changed. A supervisory commission has been set up for state enterprises. Surplus personnel are to be downsized, prices are to be adjusted, and managers are to be appointed without political influence. Future public-sector wages are to be determined by an independent salary commission, and superfluous public agencies are already being pared back.

5.4 Governance capability

When circumstances allowed, policies for economic reform in Sri Lanka have been consistent, prudent and foresighted. This has been especially true in times of crisis, and depending on the actor, also applied to the very market-friendly, even-handed policy of the central bank, and to a lesser extent also to the policies of the minister of finance. But unstable majorities, competitive populism and excessive politicization of the public sector have created almost as many constraints for organizational action as the ongoing civil war has. To that extent, the latter cannot be adduced as an alibi for every stalemating of reforms. The handling of political transformation was unfortunate for a long time, and rather characterized by backsliding into pre-democratic political behavior. Maximalist positions (an obstinate defense of the unitary state) against opponents of the civil war, chauvinistic cozying-up to nationalistic groups by both major parties, and the unscrupulous use of violence against any political opponent was characteristic attitudes of the political class.

5.5 Consensus-building

The main political actors agree with economic transformation as a goal for reform and consider all additional market-oriented structural reforms necessary. Any differences at most concern the pace and depth of economic reforms. There are no major social obstacles to these reforms. Stalemates are founded primarily in politics, and specifically in the unstable government majorities and populist-oriented competition.

Almost every social group in Sri Lanka would also agree that ethnic peace is an essential prerequisite for economic and social progress, and that it is therefore important to bring the civil war to a conclusive end. But social groups have disagreed about what concessions should be made to the Tamil rebels, and specifically how much of the Sinhalese-Buddhist unitary state should be given up, as well as what authorities the provinces should be granted under a future federal state, and how these authorities should be delineated. The groups stalemating a more generous peace solution in this regard have unquestionably grown weaker over the past two years.

Accordingly, the government has also raised the prospect of a large contribution toward reconciliation between the two ethnic groups: All refugees and stateless persons would receive identification documents, district ombudspersons would be set up for human rights complaints, bilingual schools would be supported more vigorously, and schoolbooks would be oriented toward reconciliation. As soon as the cease-fire was agreed upon, internal refugees began to receive food and emergency aid, and the most important NGOs were also involved in rehabilitation. Finally, a program for the social reintegration of former combatants has also been proposed. The government has allowed the LTTE free political activity in the North and East since the accord was signed—a concession that the LTTE has used to exclude political opponents, and that has brought the government a great deal of internal criticism. All this suggests some justification for the hope that the government is serious about peace.

5.6 International cooperation

The improved economic report for 2002 is closely correlated with the Sri Lankan government's negotiation of a standby agreement with the IMF, calling for far-reaching reforms as well as massive reductions in budget and current-account deficits. In combination with the parallel country-aid agreement with the World Bank, this agreement bears witness to the government's willingness to cooperate and make reforms. The response of the international community to the cease-fire and the peace negotiations between the government and the LTTE has been rather muted so far at the donor forum in Oslo, presumably because donors are looking for proof of a lasting will to keep the peace. In the past, the extremely complex

public procurement system has greatly reduced the capacity for absorbing developmental cooperation and the efficiency of implementation. This situation is now supposed to be much improved by the establishment of independent accounts for moneys received from developmental cooperation, together with program budgets.

In the past few years, the Sri Lankan government has given no cause to doubt its foreign-policy orientation or fidelity to international agreements. In the regional environment, it has usually acted cooperatively, and was an important force in forming and enlivening the South Asian Association for Regional Cooperation (SAARC).

6. Overall evaluation

(1) Baseline conditions: The originating conditions for Sri Lanka in the assessment period were not very favorable. Financially the central state's the scope of action was largely exhausted, due to increasing defense spending and higher costs for debt servicing. Correspondingly the possibilities for maintaining the rather exemplary state-run social security system and infrastructure also decreased. A rather critical budget balance situation came up externally and the economy definitely showed a clear lack of dynamic.

Politically and in the realm of finding a solution for the civil war, a blockade occurred; especially after the advance of LTTE on the Jaffna peninsula one could not even think about a military solution. Some of the political collateral damages of the civil war still were the precarious – and only very slowly improving – human rights situation and the high numbers of domestic refugees and emigrants. Economic collateral damage included the complete stagnation in the North and East Province.

(2) Current status and evolution: In the past few years, Sri Lanka has made progress in partially restoring its democratic regime. Deficiencies are especially evident in the rule of law, in respect for human rights and civil rights, and in asserting the state monopoly of violence. But the incipient peace process has already produced a great improvement in these indicators. Today Sri Lanka is an economy that runs largely according to market principles. Transformation deficiencies still exist in the financial sector, the reform of the civil service, labor and land law, and most significantly the reduction of excessive budget deficits. These have now been addressed with the assistance of an IMF-financed standby agreement. The first successes in stabilizing the internal and external economy are becoming evident.

(3) Management: The government's actions in regaining democratic ground must be viewed positively overall, although the two large parties still treat politics as a

zero-sum game and have not been able to resist the temptation to manipulate the constitution for their own benefit. But the management of the peace is unquestionably and clearly positive. The government has made considerable advance outlays, and has proved incomparably constructive in the negotiations. One might object that this behavior is the product of the government's own state of emergency (see above). But similar conditions by themselves have not exactly made earlier Sri Lankan governments willing to compromise.

The management of economic transformation met with little success until 2001, but was characterized instead by postponements of necessary reforms and by populist actions, causing economic dynamism to slacken sharply. Since then, there has been a clear improvement, in part externally induced.

7. Outlook

After nearly 20 years of armed conflict, the two sides in the Sri Lankan civil war showed their first serious desire to make peace in 2002. For the first time, the spring cease-fire is not being used exclusively to procure new weapons and regenerate forces for a new round of fighting. The LTTE and the government have made immense concessions, at least verbally (the former waiving a separate state, the latter withdrawing the army and offering extensive autonomy). They have proved astonishingly cooperative in the really difficult practical matters of implementing peace (demilitarization, interim administration, resettlement of refugees).

However, the Sri Lankan government is also acting within a fairly narrow time window, which may have given wings to its willingness to make peace. The majority is crumbling; the president could soon dissolve Parliament if the peace negotiations do not go as she believes they should. The Tamil rebel organizations also seem to have realized this. It would of course be naïve to claim that future economic and social progress depends solely on a peace accord. The incomplete agenda of reform is simply too extensive for that.

Politically, a further improvement in the rule of law and the preservation of human rights is on the agenda; reasonably enough, so is the long-promised revision of the semi-presidential form of government. Economically, peace would initially entail massive costs for reconstruction, primarily in infrastructure, the fishing industry (destroyed by war) and the educational system. Donors cannot be expected to do everything, especially because for the time being, they are waiting to see whether the desire for peace will last. In the meantime, there is a considerable need to consolidate the state budget, and to make other structural reforms.