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Literature review on Decay in social institution and main cause

Raja Naththige Sunil
Senior Lecturer Grade, Department of Criminology and Criminal Justice, Faculty of Humanities and Social Sciences, University of Sri Jayewardenepura, Sri Lanka

Abstract
The global movement towards social cultural and economic policy reforms has not always produced the results that were expected of it. Not infrequently, policy reforms have led to economic recession, political chaos and social disintegration. Taking Sri Lanka as a case study, we have examined the process of economic reforms and its interaction with socio-political institutions, asking how liberal economic reforms produce the results they did in this specific setting. The voluminous literature that exists on Sri Lankan economic policy assumes, almost as a matter of course, that subsequent socio-political decay has had nothing whatever to do with its economic reforms. It has held back its beneficial effects.

Keywords: movement, global, economic, cultural

Introduction

While there is no doubt that much has been achieved in terms of opening up the economy, stimulating entrepreneurial activity and promoting export growth, we have argued that liberalisation itself was a major explanatory factor in the socio-political downturn, reflecting not only the particular way in which reforms were implemented but specific characteristics of the Sri Lankan social, institutional and political setting. We find the latter was moulded by a long history of patronage, and by a strong religious-ethnic and class divide as organising principles. Over a period of some two decades, the package of policies that included economic policy liberalisation led to changes in economic structure and social institutions that set the country on a path of socio-political decay. Once on this path, economic reforms often produced outcomes that were unexpected and undesirable, and which only served to reinforce the socio-political downward spiral.

North (1996:353) concluded in his Nobel lecture that: "..transferring the formal political and economic rules of successful Western economies to Third World or Eastern European economies is not a sufficient condition for good economic performance. Privatization is not a panacea for poor economic performance". We would go further in the light of Sri Lankan experience: not only are they insufficient to ensure good economic performance but they can be implemented in a way that leads to social and economic disaster in specific settings. The Sri Lankan experience confirms that more is needed than solutions and programmes based on purely technocratic considerations. Reform programmes have to be tailored to 'fit' specific institutional settings, taking account of the predictable responses of economic and political agents to large rent extraction opportunities.

They must also be sensitive to multi-faceted distributional issues in countries that are socio-culturally diverse with inherited tensions and frictions. Unfortunately it is easier to recognise the difficulties in designing effective policies that reform moribund economies and yet retain the fabric of their societies than it is to meet that challenge. But at least the challenge becomes clearer.

Westernization and liberation of economy last 2 decade.

In recent years, almost all developing and 'transitional economies' (ex-centrally-planned economies) have implemented reforms designed to transform their state-dominated, 'inward-oriented' economies to deregulated, 'outward-oriented' market economies. The results have been, at best, mixed, and the expected outcomes, sustained economic growth and prosperity, political democracy and social empowerment, have proved elusive. A handful of countries have made a relatively smooth transition, but many more have met with political chaos, economic recession, ethnic and social conflict, pervasive corruption and various forms of authoritarianism. Achieving economic transformation is clearly not just a matter of implementing a set of liberal reforms designed by competent technocrats. Economic and institutional changes feed off each other and history, political culture and the broader institutional context in which the policies are implemented are powerful determinants of the post-reform socio-political and economic trajectory.

Increasingly, there is recognition that better understanding is needed of why economic policy changes that are expected to unshackle constraints to growth and to produce prosperity can go so badly wrong.1 In this study explores the link between economic policy reforms and broader economic, socio-cultural, political and institutional changes in Sri Lanka a country that has implemented far-reaching economic reforms since the late 1970s and 'the most open economy in South Asia (World Bank, 2000: i). In the mid-1970s, its economy was one of the most protectionist and state-controlled outside the socialist bloc. But in 1977, strongly supported by the IMF and the World Bank, it pioneered economic liberalisation in South Asia implementing a comprehensive market-oriented economic reform programme.

Today it is described by these same institutions as a positive and instructive example of economic liberalisation. 2 However, not only was its economy re-oriented, it has also experienced a profound and disturbing transformation of its society and polity. In the 1970s, Sri Lanka was widely considered a peaceful and stable democracy with an impressive record of human development by developing country standards. Today, it is a country plagued by heinous crime, violent, social and ethnic conflicts, massive and pervasive corruption, weak and ineffective government, and widespread civil and human rights abuses. Despite a promising start, even the economic performance has fallen well below expectations. Civil war and military expenditures have escalated. Public support for the government has waned, there is growing disillusionment with political leadership across the whole political spectrum and a perception of increasing social exclusion and inequality. The military is plagued by mass desertions, and civil war drags on.

At the time of writing (August 2004), even in areas outside the central theatre of war, there is a palpable sense of mass dissatisfaction: the government has lost its parliamentary majority, and the country veers from one major political and constitutional crisis to another.3 And yet, despite the striking shift from a comparatively healthy Sri Lankan polity before reforms to the palpable decay after them, most analyses of its liberalisation experience assume there is no meaningful relationship between the two. Socio-political changes are typically treated as exogenous developments, quite unrelated to the monumental shift that has taken place in the country's economic policy.4 And yet there is mounting evidence from different parts of the world (over the last decade in particular) that economic liberalisation can have a very profound and protracted disruptive effect on the structure of society.5

In several cases, social tensions generated during the ‘transition’ have erupted into violence and civil war.6 So the possibility that there could be a link was in no sense unreasonable. In this paper, we question the assumption that the political and social decay that has occurred in Sri Lanka is an entirely exogenous development, unrelated to the nature and consequences of economic reforms. We argue that liberalisation was not just a turning point in economic policy, but gave momentum to the profound and disturbing transformation that has occurred in social and political life.7

In making this argument, we do not accept the idealised picture of pre-reform Sri Lanka as a haven of peace, stability and equality. Indeed, we see the roots of post-reform problems in pre-existing, historically-evolved socio-political, socio-cultural and institutional structures, and we emphasise underlying elements of continuity. In the mid-1970s, the Sri Lankan economy had reached an impasse and fundamental changes in policy were imperative.

Economic stagnation was generating mounting socio-political instability, democratic institutions were being undermined by the authoritarian leanings of government, and the proliferation of government regulations and extensive state intervention in all areas of economic life stimulated rent-seeking and corruption. When it came, specific features of the liberalisation programme (and the manner of its implementation) reflected and interacted with pre-reform structures of socio-political relations and networks of patronage. In particular, they fed into (and heightened) pre-existing ethnic and class tensions. Not only did the liberalisation process neither reduce nor eliminate rent extraction, it expanded the opportunities on a quite unprecedented scale. Politicians, state bureaucrats and a new group, the military and police hierarchy, found a fertile ground for large-scale self-enrichment through the control of state power. However, since opportunities for corruption and patronage were directly threatened by existing political freedoms, potential public scrutiny, and normal democratic processes, incentives to undermine legal and political institutions grew.

Once locked into this path, those in control of the state ensured that the new economic reforms were designed and implemented in a way that ensured that they expanded opportunities for rent extraction. A mutually reinforcing process of economic ‘reforms’ and socio-political decay was thus set in motion. The structure of the paper is the following. Section 2 provides an overview of the pre-liberalisation era after which, in Section 3, we document in some detail the later economic and political decline. Section 4 then attempts to conceptualise some of the main processes that we see at work. Section 5 provides more detail on the necessary policy background and Section 6 goes on to elaborate our argument. It refers particularly to the experience of the present Peoples' Alliance Government (which came to power on a platform of peace, democracy and good governance and on which little has so far been written). A final section sums up the discussion and draws conclusions.

Institutions of political and welfare.

In contrast to many countries, the 1977/78 liberalisation reforms in Sri Lanka did not come in the wake of a major political or economic crisis. They were implemented by a government democratically elected on a platform of ‘opening up’ the economy. However, economic policy reforms were only part of the policy package that was implemented, alongside other political measures. The nature of this package as a whole was deeply rooted in the history, ideology and background of the government leadership. And the outcome of the reform process, including the socio-political responses that were generated, reflected specific characteristics of the Sri Lankan institutional environment, including its political traditions and entrenched values, pre-existing social, class and ethnic tensions, as well as the tensions generated by changes in the returns to various types of existing social capital. We will first look at the socio-economic and socio-political environment when the reforms were initiated, and then compare it with the situation today.

Many analysts (such as Wriggins 1960) described newly-independent Sri Lanka as a country with a vibrant, multi-party and multi-ethnic political system, a free press, a strong trade union movement and political institutions, honed by more than a century of British tutelage in which it had learnt to accommodate social divisions and communal differences.8 Even in the mid-1970s, despite significant changes, it remained a lively functioning democracy. Public meetings by major parties had large attendances; newspapers were widely read and presented radically different political positions (Jayaratnam Wilson 1975);9 membership of political or quasi-political organisations was high (Moore 1990); and parliamentary elections were regular.

Left- and right-leaning governments succeeded each other constitutionally in a manner that was exceptionally orderly, and the judiciary and the civil service were unusually independent by developing country standards. Sri Lanka was a law-abiding country. The government of Sirimavo Bandaranaike (the world's first woman Prime Minister and later leader of the Non-Aligned Movement) was projected as socially progressive and left-wing, strongly concerned with equity and distributional issues such as land reform, food security and nationalisation. And this picture was not altogether unreal, though Sri Lankan society was never as conflict free, egalitarian or democratic as it has been portrayed. There had been incidents of major political unrest in the 1950s and 1960s: a violent island-wide hartal against cuts in welfare expenditures in 1953 forced the Prime Minister to resign; anti-Tamil violence in 1957-58 claimed a great many lives; there was labour unrest and strikes including general strikes in 1962-63, an attempted coup detat in 1963 and violent street clashes in Colombo against language concessions to Tamils in 1967.

The 1971 attempt by the left-radical JVP to snatch power through a rural youth based insurrection, which was then ruthlessly crushed was the culmination of decades of simmering social tensions. The picture of communal harmony was also seriously flawed: one of the first acts of independent Sri Lanka (or Ceylon as it then was) was to disenfranchise and remove the citizenship rights of 'Indian-Tamil' plantation workers.10 And this was followed by a series of measures explicitly designed to marginalise Tamils politically (Jayawardena 1984). The traditional flag of the Sinhalese was declared the national flag in 1948, and Sinhala was made the only official language in 1956 in the teeth of strong Tamil opposition. There were violent anti-Tamil riots in 1957 and 1958 with considerable damage to both life and property. The UNP and the SLFP competed with each other to project themselves as proponents of Sinhalese-Buddhist dominance, and undermined any attempts to achieve a compromise that could, even partially, address Tamil grievances.

In 1972, Mrs Bandaranaike's government used its parliamentary majority to change the country's constitution and to extend its tenure in office by two years, a move the UNP strongly opposed. But no such protests greeted the constitutional change that made Buddhism the state religion, nor the blatantly discriminatory measures to impose regional quotas on entry to tertiary education institutions that effectively curtailed higher education opportunities of Tamil youth. In the context of a state-dominated economy where access to political patronage was a major factor in employment, this closed what was virtually the only important avenue left to them for career advancement in the workforce.

By the mid-1970s, in response to the widespread dissatisfaction among Tamils at their progressive marginalisation in social, political and economic life, even moderate Tamil leaders felt compelled to adopt a public position favouring a separate state. Small groups of Tamil youth had already started to organise to fight for it. However, growing dissatisfaction within the Tamil community had no impact on mainstream Sinhalese-dominated politics. It could be ignored because the electoral system was such that whoever enjoyed majority Sinhalese support would come to power.11 However, the 1971 JVP insurrection was a sharp reminder that ethnic issues were not the only sources of social tension within the country.

Traditional left parties had failed to deliver their promise of establishing a socialist system that improved the conditions of the masses. They suffered a massive loss of political support by being identified with austerity measures of the government and were no longer seen as a third force, offering a meaningful alternative , opening up a political vacuum in the left that the JVP was to exploit. The SLFP government also became increasingly authoritarian, and for much of its period in office ruled with emergency regulations. During its tenure from 1970-77, political interference in the judicial processes, politicisation of the public service, intimidation of political opponents and curtailment of their political rights became widespread.12

Despite these persistent and growing ethnic and social tensions, Sri Lanka continued to be seen as an outlier (or an exception) among developing countries in a great many respects. Democratic institutions had been greatly weakened but not overthrown; basic political freedoms were maintained, and the electoral system continued to function, albeit imperfectly. In addition, it had a virtually unchallenged position among low-income developing countries in terms of achievements in human development. On such indicators as the level of literacy, infantile mortality and life expectancy, Sri Lanka was not only way ahead of its South Asian neighbours, but of most other countries with comparable (or even higher) per capita income (see Table 1).

Table 1: GNP Per Capita and Country Scores on Selected Social Criteria, 1974-76

Country	**GNP per capita in US$ (1976)**	**% Primary school enrolment (1975)**	**Adult literacy (%) (1974)**	**Life expectancy at birth (yrs) (1975)**	**Infantile mortality (per 000) (1975)**	**Crude birth rate (per 000) (1975)**	**Crude death rate (per 000) (1975)**
Bangladesh	110	73	23	42	140	46	18
India	150	65	36	50	122	36	15
Nepal	120	27	19	44	--	46	20
Pakistan	170	51	31	51	113	47	16
Indonesia	240	81	62	48	--	40	17
Malaysia	860	93	60	59	35	31	6
Thailand	380	78	82	58	27	34	10
Brazil	1140	90	64	61	--	38	8
Sri Lanka	200	77	78	68	45	27	9

***Source*:** World Bank, World Development Report, 1978, Washington D.C.

This outlier status received much international attention and accolades. Isenman (1980) and Sen (1981) in particular highlighted Sri Lanka's achievement to show that, even in a relatively poor country, it was possible to meet 'basic needs' of the population through targeted state intervention. This combination of high levels of human development achievements and the maintenance of a functioning parliamentary democracy enabled Sri Lanka to retain its image of an income-poor country with a peaceful, humane and democratic socio-political system.

Socio-economic development and cultural, political decline.

All this changed quite dramatically soon after the reform program was launched in 1977/78. By 1983, ethnic tensions had erupted into violence, constitutional changes had significantly undermined the system of parliamentary democracy, and social tensions had clearly intensified. Within a decade, youth insurrection and government repression in the south and an on-going secessionist war in the north and east had combined to destroy the earlier image of Sri Lanka as a haven of peace and tranquillity. But, even then, no one foresaw the extent to which the situation would deteriorate over the course of the next decade. Let us look at the country's economic performance. On the surface, it appears satisfactory. GDP growth averaged 4.9 % per annum in the second half of the 1990s and inflation has been falling until recently.**13** In 2000, GDP growth was as high as 6%. However, these figures mask serious underlying problems that have now come to the surface.

In February 2001, erosion of the country's foreign reserves forced the government to float the currency (resulting in a sharp depreciation of the rupee) and to accept a stringent IMF austerity programme. Future growth forecasts have been scaled down sharply, the cost of living is rising rapidly, business investment has plummeted, and net foreign investment is close to zero. This situation was neither accidental nor entirely unexpected as the crisis had been building up beneath the misleading impression of a surprisingly resilient economy. First, GDP growth figures (even if they are accurate -- and they are not undisputed) have been magnified by the transient expansionary effects of military expenditures (rising to the equivalent of 6 % of GDP and 21% of the state budget).14 Second, basic infrastructure has been seriously run down because of cuts in public investment. Third, most investors have been tentative and have adopted a 'wait-and-see' attitude: there has been little new long-term domestic or foreign investment in the Sri Lankan economy, and real industrial growth has been driven largely by past investments in the early 1990s.

With a deteriorating socio-political environment (which will be outlined later), business confidence in the Sri Lankan economy has plummeted. The All Share Index of the Colombo Stock Exchange has fallen from 1194 in early 1994 to a historic low of less than 400 at the time of writing (in August 2001) -- an 80% decline in value in dollar terms. Foreign capital inflows fell to US$ 164 million in 1999, after having risen from US$42 million to US$254 million between 1990 and 1993. Even the decline in inflation has been partly a reflection of the general slowdown in the economy and reduced investment demand. High war expenditures, inadequate growth in exports and foreign capital inflows have produced a rapidly slowing economy that is poorly equipped to face any serious internal or external shock or to generate the levels of employment and incomes to absorb a growing labour force.

On the political side, a choice of indicators to describe 'decay' defined here as the systematic erosion of civil rights and democracy and the spread of corruption can be a contentious issue. But in the Sri Lankan case, almost every conceivable indicator shows much the same picture. Moore (1990) looked at 'political decay' in Sri Lanka in the early 1980s on three dimensions.

a. Centralisation of state power and manipulation of the law and the constitution to stay in power.
b. The repression of political opposition.
c. The sharpening of ethnic tensions between Sinhalese and Tamils.

All these trends were clearly present during the mid-1980s and they are now well-documented (Moore 1990; Wijesinha 1991; de Silva 1993). The point that Moore explored was whether an authoritarian government was necessary to implement the reform programme effectively, but that is no longer the issue. It is now clear that 'democratic decay' in Sri Lanka has been much more pervasive.

There are several important new elements we can see

1. The broader context of socio-political instability and civil war.
2. Widespread abuse of human and civil rights.
3. An upsurge of electoral, political and criminal violence.
4. The widespread culture of corruption and patronage in economic and political life a key link to economic policy.

Socio-political instability and civil war

Widespread political instability and civil war were not issues in the early 1980s of which Moore (1990) was writing. The subsequent period has, in contrast, been one of severe violence and of great instability. The most obvious manifestations have been the 1983 anti-Tamil riots, insurrection in the late 1980s and the ongoing civil war. However, since the mid-1990s the situation has also been characterised by intense inter-party competition for power within a ruling coalition with the smallest parliamentary majority, 15 growing perceptions of relative inequality and social exclusion (a disturbing factor, given the country's history of rural insurrection), the increasingly easier availability of modern weapons and a rise in violent crime.

The number of deaths in the anti-Tamil riots of 1983 is estimated to have been around 3,000, but its effects on the morale and security of Tamils in the south of the country was immeasurable. At least 6,000 (and perhaps double that number) lost their lives in the insurrection of 1987-89. The on-going war is estimated to have claimed more than 65,000 lives, injured and maimed tens of thousands, and made hundreds of thousands homeless and refugees. Significant numbers left the island seeking refugee status after the 1983 riots, during and immediately after the insurrection and this trend continues to date. It is estimated to have included as much as a third of the (non-estate) Tamil population (Senaratne 1997).

Economic effects of the war in terms of foregone income and investment and the damage to infrastructure and resources (cumulative from 1983 to 2000) have been estimated as equivalent to twice the country's 1996 GDP.16 Periodic bomb explosions in the south (most notably the bombing of the Central Bank in 1996 and the Colombo International Airport in 2001) have had a major adverse effect on the country's tourism and on the relative attractiveness of the country to potential foreign investors. Many of the poor could only find employment in the country's armed services and, as casualties increased, this generated resentment in the rural areas (Dunham and Jayasuriya 1998). Over and above that, the impact of the war on social and political life has been both profound and insidious resulting in a gradual criminalition and brutalisation of our Sri Lankan society. ok

Civil rights and abuse of human.

As Druze points out, war typically sees the curtailment of civil liberties, and Sri Lanka is no exception. However, until recently, the direct impact of the civil war on life outside the war-zone in the southern part of the country, and more especially Colombo had (with the exception of those who had experienced the trauma of family deaths or injuries) been relatively minor. Security concerns had a predictable effect on people's freedom of movement, but the war was elsewhere, and it was factored into everyday life that went on much as usual. For a minority, however, there had been effects that were more disturbing, that can be traced back to the insurrection, if not before. Concerns over the systematic abuse of human and civil rights during the Premadasa regime (which were much publicised and a cause of protest both domestically and in the donor community) were a major factor in the electoral defeat of the UNP in 1994.

After a brief period of improvement, the situation has once again deteriorated sharply in recent years, albeit this time more for Tamils than for the Sinhalese. The evidence on this score is considerable and it has been disturbingly consistent. Emergency laws, giving draconian powers to police and the armed forces, have become the norm. According to Amnesty International, during and immediately after the 1987-89 insurrection, "tens of thousands of extrajudicial executions and 'disappearances' were committed" (Amnesty International 2001). 17 "Torture, including rape, [have] remained common, both in the context of the armed conflict and in routine policing operations" (Amnesty International 2000). Thousands have been arrested and kept in long-term detention without trial (sometimes secretly); numerous 'disappearances' of people taken into custody have been recorded,18 and torture is reported to be used to secure confessions from suspects in common criminal cases.19

There have been frequent allegations and several well-documented cases of rape (sometimes followed by murder) by armed forces personnel not only in the north and East but even in other parts of the country. There have also been several incidences where detainees have been murdered.20 Press censorship has been enforced and independent media personnel have been physically threatened, and on occasions killed.21 The independence of the police and the judiciary has also been seriously abused. A Presidential Inquiry into events that occurred during and after the insurrection found, for example, that politicians of the ruling party had treated the police as an extension of their own political power, regularly providing lists of 'terrorist suspects' who were to be taken into custody, which, when checked, were found to be supporters of opposition parties.

The adverse influence of politicians on the police and on the rule of law (using them to settle local disputes) is a continuing cause of concern, with a particularly adverse effect on the poor who have no means of opposing them. Non gavenment organition points to "the nexus between local police and local politicians, widespread corruption within the force and a general lack of independence on the part of the police as major contributory factors in the torture and mistreatment of suspects". Amnesty International (2001) reported that impunity for the perpetrators of human rights abuses remained a major concern with victims who sought justice through the courts receiving death threats.

The increase in political, electoral and criminal violence Island wide.

The electoral process has also broken down in much of the country, with electoral violence and vote-rigging occurring on an unprecedented scale. Three major politicians of the UNP government of the early 1990s (the President, Ranasinghe Premadasa, and the two most powerful ministers, Lalith Athulathmudali and Gamani Dissanayake) were all assassinated during election campaigns. In the 1998 Provincial Council elections, the 1999 presidential and the 2000 parliamentary elections, campaign violence, ballot stuffing, impersonation, intimidation and other abuses were rampant and were widely documented, seriously eroding their legitimacy in the eyes of the Sri Lankan public. The European Union, that sent observers to the parliamentary elections in October 2000, made a statement to the meeting of aid donors in December 2000 in which it "regrets and condemns the anomalies observed during the campaign and the violence that took place during the voting" and requested that "the perpetrators of that violence and those irregularities be found and brought to justice".

The Deputy Minister of Defence, in charge of much of the daily running of the defence establishment, was accused by opposition and independent groups and by two government Ministers of organising widespread ballot rigging and intimidation of voters in the Central Province using groups of armed thugs led by his son. **22** Violence has also percolated more broadly into everyday life. Of roughly 25,000 deserters from the Sri Lankan Army, between 5,000 and 7,000 are estimated to have left with their guns. Senior police officers admit that they are unable to protect ordinary citizens from escalating crime (increasingly involving armed violence) because their resources have been transferred to provide security for prominent political figures and major economic targets.23 Death squads (allegedly state-sponsored) were at work in the early 1990s, and there have been hints of a possible resurgence in the wake of open activity by armed gangs during the recent elections.

In May 2001, clashes between Sinhalese and Muslims occurred in a provincial city triggered off by an incident where gangsters reportedly enjoying the patronage of a Deputy Minister assaulted a Muslim shopkeeper who refused to pay protection money. Property belonging to Muslims was allegedly set on fire while police looked on. Subsequently there were clashes between police and Muslim demonstrators in Colombo. In July 2001, police assaulted opposition supporters who protested against the suspension of parliament (after the governing party lost its majority) and several deaths were recorded in Colombo as a result of police shootings. In so many respects, the rule of law and state protection has broken down, particularly for the poor, opposition groups and minorities.

Development in bribery and corruption.

Patronage is one thread that runs throughout the developments that have just been outlined, and it has always been a characteristic of Sri Lankan party political life. In the 1970s, being in power meant control of the state (which was a major employer) and of a reservoir of state patronage. In the post-reform period, state employment has declined, but other sources of patronage have emerged to take its place. Foreign aid, economic reforms, and massive military expenditures have provided new and lucrative sources of corruption. Corruption of course is not new, what has changed is the scale and pervasiveness (Wriggins 1960:335). Sri Lankan political life had seen instances of corruption as far back as the immediate post-independence period, but it had been largely confined to accusations of nepotism and minor financial transgressions.

Until the late 1970s, bribery and other forms of corruption by the political and administrative elite were generally minor and relatively small-scale.24 But, with the massive inflow of foreign aid to the Mahaweli and the other main projects, the opportunities for personal gain suddenly increased enormously. Politicians and the bureaucrats administering projects began to benefit significantly, and the payment of unofficial 'commissions' became increasingly the norm as corruption was institutionalised. In the 1980s, when funds to 'lead projects' dried up, the scope for large-scale corruption of this nature was reduced, only to be revived with privatisation in the early 1990s which saw very little transparency (on this see Dunham and Kelegama 1997).

The escalation of military expenditures from the mid-1980s also introduced another dimension to the corruption and patronage. It had two principal strands to it. Large-scale military purchases from abroad provided opportunities for brokerage, yielding significant commissions for military personnel and the politically-favoured civilians who became involved. And, domestically, expansion of the military and security-related activities presented opportunities in tendering and the state purchase of goods and services. The security situation was also one in which there was enormous scope for blackmail, exploiting vulnerable figures against whom accusations of having sympathies or contacts with the Tamil Tigers (or just being a security risk) could be relatively easily contrived. The latter was a development made all the more viable by the general erosion of state protection and civil rights.**25**

Deterioration in the socio-political life of a country is always difficult to measure, but clearly, the cumulative picture we have painted contrasts strikingly with the situation of Sri Lanka in the 1970, however imperfectly it was presented. The 1990s appears to have been a watershed in many ways. Even at the beginning of the decade, Sri Lanka's outlier status in South Asia was not under serious challenge though, on economic indicators, the rapidly-growing East Asian countries had overtaken it and were catching up (or already ahead) on many human development indicators. This may have had more to do with the dismal performance of other South Asian countries than with any remarkable progress on the Sri Lankan side, but the country could take pride in the fact that both economically (in per capita income terms) and socially it was still the most advanced country in the region. By the end of the 1990s, even that was in question. With one obvious exception (Pakistan), economic growth had accelerated in the other South Asian countries and social and political conditions had improved relative to those in Sri Lanka.

They may even have surpassed them in some areas. At the start of the new millennium, on most criteria, Sri Lanka is no longer the "best bet" even in South Asia. Overall, the reality of political and social decay, combined with modest economic performance, has meant that Sri Lanka is fast becoming an example (alongside Lebanon and Kashmir) of how a society that once seemed a model of communal harmony and relative prosperity can drift uncontrollably downwards. Before proceeding to discuss the interaction between the economic reform process and the Sri Lankan 'institutional' context produced this extremely bleak outcome, we need first to discuss mechanisms by which economic reforms in specific institutional contexts can lead to negative socio-political changes.26

Inequality in liberalisation, corruption and violence

Any analysis of the political responses to fundamental economic reforms has to begin by recognising that they are accompanied by profound distributional changes. Even when reforms lead to faster growth and higher average incomes, the gains are not distributed equally. At least in the short-term, there is often a significant number of losers. We have argued elsewhere that transition from a rigid, insular, state-dominated economy to a deregulated market economy can lead to major changes not only in actual, but also in perceived inequality, with perceptions magnifying changes in expected gains and losses (Dunham and Jayasuriya 2000). 27 Policy and institutional reforms have profound effects on the underlying determinants of asset returns (through the revaluation of skills and other human capital, social capital embodied in various networks such as ethnic and religious networks as well as physical capital).

Net wealth positions of households and individuals are redefined. These actual or potential distributional changes can then prove a potent source of social and political conflict, often along already existing social 'fault lines' – class, ethnic, religious and regional. This is particularly so when liberalisation fails to generate a rapid expansion of the total economic pie. However, the social impact of policy reforms is not confined to their impact on wealth and perceived inequalities.

They can also create new opportunities for rent extraction through access to political power and regulatory institutions and they can change the scale of the potential gains quite dramatically. The extent to which such rents can be appropriated then depends on specificities of the political and social environment. It is important to note that the reform agenda itself has undergone significant changes since the 1970s, and that it has been broadened in a way that magnifies these possibilities.

In the late 1970s, emphasis was placed on the implementation of specific pro-market policies in particular trade liberalisation and complementary changes to the exchange rate regime. Moreover, the initial reformers were very much innovators, lessons of the Thatcher and Reagan years were yet to come, neo-liberalism and economic reform were new and they were also politically contentious. Unless a government had crushed the opposition (as had been the case in Chile), it could ill-afford to run ahead of its political constituency and it had often to deliver quick and tangible benefits to maintain popular support. But as time went on, and more particularly after the demise of the USSR in 1991, the reform programme changed quite markedly to mean a fundamental transformation and deregulation of the whole economy.

It was to involve not simply trade and exchange rate liberalisation, but the dismantling of state controls over domestic and international trade, the freeing of capital flows and financial markets, and the drastic reduction of state ownership, including areas such as basic public utilities, traditionally considered the natural domain of the public sector. By the early 1990s, after the fall of the Soviet Union and the adoption of pro-market policies in China, a plausible socialist alternative had effectively ceased to exist. With widespread acceptance of the neo-liberal agenda, the political context in which reformers operated became distinctly different. Liberalisation was mainstream. Governments were no longer faced with viable policy alternatives. Willingness to acquiesce and embark on a liberalisation programme secured the blessing of international financial institutions and the prospect of possibly significant rewards in terms of large-scale foreign capital inflows and foreign aid, whereas resistance no longer appeared to offer tangible benefits.

Market liberalisation was increasingly accepted throughout the political spectrum as essential for promoting growth. Not only was liberalisation seen as growth promoting, it was also seen as significantly undermining conditions that produced corruption and other forms of rent-seeking behaviour. Though state controls are by no means the only mechanisms that create rent extraction opportunities, the literature on rent seeking behaviour beginning with Tullock (1967) and Kreuger (1974), has often given the impression that it is fundamentally rooted in state controls, and this has led to a widespread assumption that that liberalisation and deregulation would – if and when achieved -- lead, almost as a matter of course, to its gradual but inevitable demise.28

In practice, complete liberalisation and deregulation do not occur overnight. Liberalisation is a process that proceeds in steps and is staggered over a period of time. Because partial liberalisation necessarily takes place in a 'second best' context, economic theory suggests that economically inefficient outcomes cannot be ruled out, particularly when many market institutions are either imperfect or completely absent.29

The liberalisation process itself also generates new incentive structures and reward systems. In particular, in the context of a reform programme aimed at a complete transformation of state-dominated economies, it opens up rent-seeking opportunities on an hitherto unprecedented scale. While the final outcome of a successful liberalisation programme will be a diminished role for the state, during the transition period the state controls the liberalisation process, and those who control or who can influence the state find themselves in a highly privileged and very fortuitous position. The state decides which sectors are liberalised (and in what sequence), which activities are to be privatised, how tendering will be dealt with, and what will be the terms of any eventual sale to the private sector (see Stewart 2000: 248). With privatisation, it is possible for the first time to sell off valuable state assets, most notably public utilities (such as telecommunications, energy and transport), as a core component of a government economic policy programme.

Arguably, the short-term rents that can be extracted as a 'stock' from privatisation far exceed the gains from nationalisation which may yield a flow of benefits over a longer period. And as many of the buyers are foreigners, the opportunity for corrupt transfers of funds to safe overseas locations provides an added attraction. The extent to which this takes place clearly varies and it is always in part conditioned by the political context, but the potential is nevertheless there.30 From the viewpoint of the private sector, economic liberalisation also means that the potential rewards for investment become correspondingly larger. Both domestic and foreign entrepreneurs are willing to pay more for the opportunities offered than in the pre-reform era. Liberalisation of foreign investment is a central part of the reform agenda and, not surprisingly, FDI inflows often increase even before the implementation of a complete set of policy reforms, in anticipation of higher future profitability.

The selective application and manipulation of trade and investment liberalisation is a powerful weapon that can be used to political and personal advantage. As with privatisation, the conduit role of the state (and of its leading figures) does not disappear. Most FDI has to be formally approved, designated sectors can obtain extra assistance, while others can find themselves faced with various regulatory barriers (national security, environmental protection, cultural objections etc).

Thus, it is not surprising that in many countries those in charge of dismantling control regimes and the privatisation of state assets have found new and greater opportunities for nepotism and for lucrative rent extraction.31 How much of a problem this poses to the implementation of economic reforms is partly an empirical question and it is a matter of considerable debate. Many supporters of liberalisation see any corruption in the course of reform as a transitory phenomenon, a cost society has to bear until it has an efficient market economy, in the belief that liberalisation will "reduce the opportunities for corruption in the long-run" (Tanzi 1997:168). However, such a fortuitous outcome is in no sense inevitable. As we have seen, liberalisation can provide additional resources for existing structures of patronage, and it can also create new structures whose interests are in no sense compatible with a liberal economy that eliminates rent extraction.

The liberalisation process then becomes 'distorted': it can produce outcomes that not only diverge from the ideal of its proponents but that even ensure the entrenchment of a system that ensures smooth and unabated rent extraction. In other words, the liberalisation process becomes 'path-dependent', with outcomes increasingly diverging from what may be economically 'efficient'. The danger then is that, as the stakes get higher, political power is sought for the control it gives over the distribution of a potentially rapidly expanding pot of economic resources (Stewart 2000). Holding on to power becomes a matter of fundamental importance, both because of the largesse and influence it yields and because of the much increased cost of being marginalised as losers. As a result, incumbents become more willing to subvert political institutions, processes and movements that threaten their grip on power.

Public scrutiny and dissent is suppressed, activities of political opponents and their supporters are undermined and democratic freedoms are eroded. Contenders for power often find group cohesion, and the ethnic or class differences that can spark it off, a powerful mobilising force in the competition for resources (Samarasinghe and Coughlan 1991; Stewart 2000), there is less concern with transparency, and perceptions of inequality and social exclusion begin to mount. When combined with the redefinition of asset values and related changes in wealth and incomes, this can become a recipe for acute social and political conflict, as disgruntled social groups provide bases of political support for rent seekers to pose as defenders of a wider 'public' interest. But, then, what determines whether a country proceeds on a 'golden' path of steady growth and development or gets locked into a downward spiralling 'destructive' path? In our view, Sri Lankan experience provides useful insights into such a question. However, before we examine the socio-political impact of liberalisation in Sri Lanka, some background information has to be provided on the country's reform process.

Background of bribary, Corruption, violance and politicians.

The combination of selective liberalisation, the PSIP and growing authoritarianism provided a particularly favourable framework for corruption to flourish. The rewards of being in office were now much greater than ever before. Losing and being in opposition, on the other hand, was an experience of abject humiliation and powerlessness (Wijesinha 1991). The Mahaweli and the other 'lead' projects offered almost unlimited scope for patronage and for financial gain via the various contracts and commissions that they generated. Politically- favoured state enterprises also continued to enjoy substantial fiscal transfers. For example, annual subsidies to the national airline, Air Lanka (where Jayawardene's son was prominent) were larger than subsidies to public transport, and sometimes exceeded the total expenditure on food subsidies.

At first, corruption failed to surface as a major political issue. Rapid growth of the economy produced high expectations and the public was willing to tolerate some degree of corruption as part of the price for a dynamic economy after many years of shortages and economic stagnation (Samarakone 1984). However, when the initial surge of growth started to moderate in the early 1980s, popular dissatisfaction with the regime began to mount. As early as 1982, there was considerable popular dissatisfaction in evidence. There were widespread allegations of vote rigging in the presidential elections that saw re-election of Jayawardene. He then refused to hold parliamentary elections due in mid-1982 and decided to extend of the life of the parliament (where it enjoyed a two thirds majority) through a referendum, an event which Manor 1984) was to describe as "the most dramatic change in political practice in Sri Lanka since Independence". The referendum itself was marked by contempt for the law, detention of opposition leaders, widespread thuggery and intimidation and considerable vote rigging (Samarakone 1984).

A growing perception among all layers of the population that normal legal and parliamentary forms of political protest and change were being closed coincided with the economic slowdown and perceptions of heightening inequality and alienation among important segments of the population. As we already noted, implementation of the PSIP had a negative impact on the establishment of labour-intensive export- oriented industries that might otherwise have expanded more rapidly in response to liberalisation measures. The selectivity in trade liberalisation and the political patronage associated with the PSIP had increased the sense of marginalisation among Tamils. Cuts to consumer subsidies and the emergence of a 'new rich' aggravated perceptions among the low-income youth that the development strategy of the government was pro-rich and anti-poor.

With old avenues for expressions of dissent and protest shut off, there was widening support for extra-parliamentary forms of struggle, particularly among Tamil and Sinhalese youth who felt themselves to be excluded from the 'new economy'. Among the Tamil youth, a secessionist movement, the Liberation Tigers of Tamil Eelam (LTTE), began to gather force. Among the Sinhalese, the JVP became revitalised and gained support, particularly in rural areas.

When there were widespread anti-Tamil pogroms in 1983 – allegedly with the complicity of some sections of the military – the initial response of the government was heavy-handed and unsympathetic, paving the way for a major shift in Tamil attitudes towards separatist movements and escalation of the conflict. And as the regime became increasingly mired in a drawn out military conflict in the north and east, the pace of economic reforms slackened as did economic growth. The nature of the emerging regime became more visible. It was deeply unpopular and, according to Moore, it was kept in power by a military-cum-political intelligence apparatus and by arming its cadres the latter a trend that was to be perpetuated. The authoritarian character of the regime was increasingly resented, in turn requiring a firmer hand to retain control. Popular dissatisfaction grew in the rest of the country and produced another violent youth insurrection that paralysed much economic activity in many parts of the country in the late 1980s.

Rrepression, liberalisation, corruption and growth.

As described earlier, the second JVP insurrection was ruthlessly crushed by the new president, Premadasa, who established a virtual dictatorship. He faced not only the political challenge of dealing with the insurrection but also a major economic crisis in 1989. His response was firm and effective. He negotiated an agreement with the IMF and implemented a second wave of liberalisation reforms that for the first time placed privatisation as a major item on the government's policy agenda. The economic policy framework that was established gave strong incentives to growth in the short-run. The economy recovered strongly with the re-establishment of political stability, liberalisation enhanced the incentives for export-oriented production, foreign investment started to flow in, export industries (particularly the textile and garments sector) expanded rapidly, and a general sense of optimism about the country's economic prospects began to emerge within the business community, both foreign and domestic.

A period began in which Sri Lankan economic and political regimes resembled that of the Suharto regime in Indonesia. The government was perceived as corrupt and dictatorial but at the same time efficient. Power and decision-making were centralised, dictatorial practices of the President were increasingly blatant, corruption was institutionalised (and allegedly streamlined within the presidential office), but there was also policy clarity and stability. Business confidence grew that there would be no labour problems or other forms of disruption to economic activity.

Many started to speculate that Sri Lanka was at last on the way to emulating the East Asian NICs. But this was a short-lived dream. Such a drastic change could not be imposed on the institutions of Sri Lankan political and social life for long without a reaction. Despite economic successes, political opposition widened and produced an escalating wave of repression. After a series of yet to be solved murders of key political opponents of the President, he was himself assassinated in 1993. New elections were held in 1994 that saw the Peoples' Alliance led by the SLFP come to power pledging to an end to the war and negotiate peace with the separatist LTTE, and to provide clean, transparent and democratic governance, and pro-poor economic policies. In particular, it adopted a strong anti-privatisation stance.

Privatisation, corruption and authoritarianism.

Initial expectations were that the PA government – a coalition including communists and ex-Trotskyst parties -- would at least slow down the liberalisation process if not reverse it. Instead it committed itself to continuing the reform agenda, and it has been working closely with the IMF and the World Bank in devising economic policy.55 There has been no major backsliding on policies already in place and the few consumer subsidies that were introduced in the early days of the government have since been largely withdrawn. In the political sphere, it has emulated (if not overtaken) the previous regime in terms of election-rigging and political corruption. And it is both instructive and revealing to ask how and why it moved so rapidly to behave in way that, in so many respects, makes it virtually indistinguishable from its predecessors.

It is useful to start by examining one area in which it has moved ahead of the previous regime, namely in privatisation.Though it recently signed a Letter of Intent on a conditionality agreement with the IMF that commits it to several measures that are likely to be highly unpopular, the PA government has generally balked at implementing any major policy reforms that might generate widespread popular opposition. The only area where it has moved ahead with speed is in the area of privatisation, having (either fully or partially) privatised a range of enterprises including the national airline, telecommunications, plantations and ports. For a government that came to power on an anti-privatisation platform, this rapid reversal strategy once in power proved surprisingly easy. On reflection, however, it is also easy to understand.

As we pointed out earlier, privatisation of state assets, particularly large and valuable public utilities, offers the possibility for large-scale rent extraction. The relatively minor privatisation measures implemented earlier by the Premadasa government had already demonstrated this point, albeit on a limited scale. Politicians in opposition (and their favoured friends and supporters) who had experienced the political muscle of his increased funding and largesse learned the lesson well. nd, indeed, the PA government has gone further. It has demonstrated that rent-seeking can be continued even after privatisation and that regulatory powers that control the degree of competition to be permitted in a particular market can also provide a powerful source of additional funds.

Faced with these incentives, not only did it renege on an explicit promise not to privatise the telecommunications industry, it shifted its regulatory stance to one that was clearly aimed at restricting competitive pressures on the privatised entity (Jayasuriya and Knight, forthcoming). Moreover, the political interests of politicians who are in a position to extract continuing rents from privatisation exercise now coincide with those of others who can extract rents from the other major continuing source, the country's civil war. It has become quite clear that the powerful pro-war lobby that exists within the government has so far had been powerful enough to ensure it made no concessions that could lead to negotiations for peace. Shared economic incentives lead to shared political interests.

Continued access to political power is essential to maintain access to these lucrative sources of massive wealth, and it produces a coalition within government ranks (with some outside participants) that can stifle initiatives to establish more transparency in government purchases, contracts and other commercial dealings. It is this wealth that is now the main source of finance for the maintenance of patron-client relations that continue to provide the bases of political power and influence. The state enterprise sector has shrunk, and this has diminished (but not eliminated) opportunities for exploiting the state apparatus to dispense employment and other benefits.

This problem has been circumvented to a considerable degree by the massive expansion of the ministerial posts and privileges (ballooned by coalition politics), and more generally of the now-extensive privileges of all politicians.56 This process has been facilitated by World Bank initiatives for the decentralisation of government finances. In practice, this enables politicians to access considerable funds that they can used to buttress their patron-client networks at local level. And, in combination, these processes have entrenched a system of political corruption that subverts political democracy and judicial independence. In turn, they create incentives for others to establish organisations and forms of activity that can challenge them: teams and individuals excluded from the game by adjustments to the rules seek new games and new rules!

Corruption and the poiteciance regime

For all the similarities, there are also several significant differences between the present regime and its predecessors particularly the de facto dictatorship under President Premadasa. First, there is no centralisation of corruption the weakness of central authority has been reflected in a ‘democratisation’ of corruption and a plurality of centres of influence-peddling. The government, lacking an effective parliamentary majority, depends on minor parties and individuals remain in power. The situation is particularly fluid because the strong ideological differences that existed up until the 1980s has now disappeared.

This enables politicians to switch allegiances with much greater ease than had been the case in the past. It also strengthens patronage politics and in many ways legitimises rent-seeking behaviour, while widening competition for rents.In terms of the theoretical models of corruption, the current regime in Sri Lanka possesses elements of two behavioural types. First, as Shleifer and Vishny (1993) point out (and as mentioned in many private discussions in Sri Lankan business circles), the economic outcome of decentralised corruption is greater economic inefficiency.

Each corrupt politician/bureaucrat/military officer acts with no regard for the impact of his or her rent extraction on other people, and economic agents’ face higher costs because they are forced to pay a bribe but cannot be sure that they will not have also to pay others. Second, economic efficiency is lower with a ‘roving bandit’ than with a ‘stationary bandit’.A stationary bandit expects to share in any future wealth generated by the community and does not therefore ‘kill the goose that lays the golden egg’. A roving bandit, in contrast, has no such expectations and maximises loot that can be extracted in the short-run. The contrast between the PA regime and the previous UNP regimes, particularly the Premadasa regime is in this respect instructive. First, compared with the centralised corruption that took place during the Premadasa regime, the politically weak PA regime (a multi-polar coalition loosely held together by the need to stay in power) is unable to centralise corruption.

It can never afford to alienate groups and break the coalition. Second, the fragility of its grasp on power makes its behaviour closer to that of the roving bandit model: as the planning horizon gets shorter, incentives to implement long-term growth-oriented policies are correspondingly lowered. Politicians are aware (even as they strive to maintain their hold on power) that they might not be around to capture potentially larger future rents from a growing economy that could be obtained by sacrificing current rents. Both models lead to the same efficiency conclusion: a band of many roving bandits provides a worst case scenario. However, we have so far ignored an important economic agent in this context, namely the business community, which could play a stronger role in future.

Nearly a quarter century after the initiation of liberalisation, the business community is beginning to flex its muscle openly on the Sri Lankan political scene. In contrast to the pre-1977 period, it has expanded significantly in the past two decades, exploiting opportunities presented by a more liberal economic framework, however distorted. Its first independent foray into the political sphere was to take the initiative to lobby for a negotiated peace to the ethnic conflict. Though that met with little success, it may yet play a much more important political role as a slide into political and economic chaos threatens its basic interests. If that were to occur, the longer-term scenario for Sri Lanka may yet prove different.

Liberalisation and socio-political decay in policy

The background of Sri Lankan policy

The Asian Legal Resource Centre is a regional, independent non-governmental organization with General Consultative Status with the Economic and Social Council of the United Nations. It's mission is to promote and protect human rights through strengthening the rule of law and administration of justice at national and local levels and effective implementation of international human rights treaties at the national and local levels. In fact, the shortcomings mentioned in this report are of such fundamental nature that they have affected the rule of law and the basic democratic framework of Sri Lanka. Often analysis of human rights in Sri Lanka is premised on the assumption that violations of rights are mostly due to the civil strife in the North and the East and that consequently, the resolution of this problem is the most important way to improve this situation.

Close observation of the sequence of events that led to the breakdown of law and order in Sri Lanka demonstrates that such an assumption is not only simplistic but also fatally flawed. It can even be argued that without a serious attempt to improve the institutional framework of the rule of law and democracy in the country as a whole, no lasting solution can be found to the conflict in the North and the East of the country. In fact, the cease-fire agreement that has existed in recent months shows that in order to make further progress, it is essential to deal with the country's longstanding problems relating to the rule of law. Also, for people in other parts of the country-where the vast majority of the population lives-delays in dealing with the denial of basic rights due to institutional failures have caused tremendous insecurity.

At the time of independence from Britain in 1948, Sri Lanka (then Ceylon) had an open economy, and it remained so until 1956, under a right of centre party (the United National Party, the UNP). It inherited an extensive system of ‘welfare services’, including universal free medical care, universal free education and subsidies for major food staples, initiated under British colonial rule during the 1930s, and this was greatly expanded in the early post-independence period. The establishment of this ‘welfare’ system was at least partly motivated by the political objective of neutralising the political challenge of powerful Trotskyst and communist parties that controlled a large and militant trade union movement.32 And the system was financed by trade taxes on export commodities (tea, rubber and coconut). An attempt by the UNP government to cut food subsidies in 1953 (to reduce the fiscal burden) brought the country to the verge of revolution, forced the government to retreat and ensured that ‘political commitment to food subsidies was sealed once and for all’ (Snodgrass 1966).

A left-leaning coalition (headed by the Sri Lanka Freedom Party the SLFP) came to power in 1956, and imposed import controls in response to balance of payments difficulties. It progressively adopted an inward-looking ISI-type economic strategy with domestic market regulations, further import controls, and broader state involvement in economic enterprises. This trend was interrupted briefly in 1968, when there was a half-hearted and short-lived liberalisation attempt by a UNP government. However, it resumed when the latter was swept from of power just two years later by a SLFP-led coalition (that also included the two major leftist parties) with Mrs Sirimavo Banderanaike as Prime Minister. This government greatly increased the role of the state in the economic life of the country.

Major sectors of the economy were nationalised, administered prices became pervasive, international and domestic trade were stringently controlled, and by the mid-1970s Sri Lanka was one of the most state-dominated economies outside the Eastern bloc (Athukorala and Jayasuriya 1994). Though some private firms enjoyed political patronage and benefited from import controls, the private sector as a whole was marginalised in the economic and political spheres. The environment was generally hostile to domestic and foreign investment. Importantly, the period was one of severe economic difficulties (partly due to the severe impact of the 1973/74 oil shock and adverse international price movements).

As a result, ISI policies and state controls became widely unpopular, being identified with shortages of essential commodities and economic hardships, and memories of them linger on in the public mind even after nearly three decades.33 As a result, in 1977 the UNP, campaigning on a platform of "an open economy" was swept back to power in elections with an overwhelming parliamentary majority. It implemented a package of economic policy changes with three major components. First, it instituted far-reaching trade and exchange rate liberalisation almost immediately, removed most of the domestic price controls, established export-processing zone, implemented other measures to attract foreign direct investment, and eased financial repression (Cuthbertson and Athukorala 1990). Second, it reduced some key consumer subsidies, including that on the staple cereal, rice.

Third, it put in place an enormous public sector investment programme (PSIP), centred on a major irrigation-hydropower-cum-settlement project (the Accelerated Mahaweli Development Programme) and financed with massive aid flows from international agencies and western governments.34 As we shall show later, these three separate components of the government programme were to prove quite critical in determining the future economic and political path of the country, though the second and third elements were in no sense central to the liberalisation reforms. The immediate effects of these policies on economic growth were quite substantial (the average annual growth rate was around 6%), though the main driving force was not liberalisation but the PSIP. It was partly financed by domestic resources and, despite foreign aid support, generated large budget deficits that were monetised resulting in high inflation.35

As public investment declined after the initial surge, growth slackened and then collapsed in the late 1980s (to 1.5% in 1987). By this time, political disruption had begun to take its toll on the country. Ethnic conflict had erupted into civil war in the North and East of the country after 1983 and a youth insurrection paralysed economic life in the other parts of the country from mid-1987 to end of 1989. Military expenditures soared. The liberalisation agenda was not taken further (though nor was there any major backsliding on what had been already implemented). In 1989, however, a balance of payments crisis compelled the government to seek IMF support. An accelerated programme of further economic reforms formed part of the conditionality agreement and ushered in a ‘second wave of liberalisation’ in the early 1990s under a new government led by Ranasinghe Premadasa (who replaced J.R. Jayawardene as UNP leader and President in 1988).

This programme comprised several components: a standard IMF stabilisation programme, a number of "bread-and-butter" reforms (including trade policy, exchange rate and tax changes) and three politically high-profile projects, export promotion, privatisation and the alleviation of poverty (on this see Dunham and Kelegama 1997). These policies, following the crushing of the youth insurrection and a de facto acceptance of the status quo in the on-going secessionist war, were initially successful in stabilising the economy. They attracted foreign investment, stimulated exports and improved economic growth (to an average 6% p.a.). However, despite all this, the UNP government lost electoral support in 1994, being widely perceived as grossly over-centralised, authoritarian and downright corrupt. Economic momentum generated by the reforms it had implemented nevertheless spilled over into the People's Alliance government of Chandrika Bandaranaike-Kumaratunga.36

Under the new regime, core elements of the liberalisation programme have been continued and in some areas taken further (most notably the full or partial privatisation of plantations, energy, telecommunications and the national airlines, Air Lanka), but growth could not be sustained -- falling to 4.3% in 1999 (Central Bank 2000). A deteriorating economic situation forced the government to float the currency in February 200 and, in March 2001, to agree to a programme of severe austerity measures and further reforms to obtain an IMF Stand-By Arrangement. Thus, in economic terms, the opening up of the economy seems set to continue. In the next section, we look at the way the economic reform process interacted with the Sri Lankan ‘institutional’ context, producing outcomes that were unanticipated by the proponents of economic policy reform.37

Liberalisation and socio-political decay in Sri Lanka.

"Path dependence means that history matters (North 1990:100), and in Sri Lanka it is a point that needs to be stressed: the mould was not cast overnight with the opening up of the country's economy in the late 1970s. In many respects, for all the stark contrast that can be drawn with the pre-liberalisation period, its subsequent evolution reflects profound underlying continuities. And, in our view, an important element of continuity has been in precisely those areas for which the country was praised internationally, the nature of its political system and ramifications of its long and remarkable history of welfarist policies. They structured attitudes and expectations; they nurtured relationships of paternalism and dependence that were particularistic and discriminatory, and they were highly influential in shaping the subsequent evolution of civil society.

When opportunities for gain increased after the opening up of the economy, it was they that provided the breeding ground for enhanced patronage and corruption, heightening perceptions of ethnic, class and regional inequalities and fostering democratic decay. The Sri Lankan decline is most evident, and its analysis also considerably complicated, when it comes to the civil war. On the one hand, roots of the ethnic conflict and ethnic competition for state influence and resources go back well into the pre-independence period (Wriggins 1960; Manor 1984; Jayawardena 1986). On the other hand, democratic decline is also fairly typical of countries that have been overtaken by civil wars (Collier 1999; Drèze 2000).38 So the influence of economic liberalisation is neither clear-cut nor perhaps immediately obvious. But that is not to say that the sequence of 'liberalisation then civil war' is coincidental. Some scholars have suggested that the decay has been triggered off by political circumstances (Moore 1990; Senaratne 1997).

Others have argued that economic motives loom far larger in such events than is generally realised (Samarasinghe and Coughlan 1991; Stewart 2000). It is the latter possibility that we explore in this paper. Looking first at the Sri Lankan political system, it is widely accepted that it has always been elitist, exuding strong attitudes of paternalism towards the rest of the populace, and towards the peasantry in particular.39 However, one of its distinctive characteristics (unlike so many other countries) was that there already existed a very real notion of the (Sinhalese) state, 40 and a widespread belief that state power had to be legitimised by using it wisely for the benefit of its citizens (Ryan 1953). As a result, the peasantry was never completely neglected.

However, Tamil and Muslim minorities could only gain access to power by allying themselves with one of the major Sinhalese parties (though their position was often constrained by use of the ethnic card in the internal struggles that were taking place within Sinhalese politics). 41 The result, as Moore (1985) has pointed out, was that politics in the countryside was never really about policies. It was driven by competition between families, factions, villages, parties or ethnic groups for a bigger share of the very substantial pot of resources that the state was allocating, and by the struggle for key positions of influence over the selection of beneficiaries.

A major inheritance of welfarist policies of successive governments was thus in essence a clientelist state structured by networks of patronage. The pot of resources at the government's disposal that underpinned it came from government revenues collected through export taxes on the traditional exports. However, the secular fall in tea and rubber prices and the erosion of the exportable surplus in coconuts produced steadily falling revenues. At the same time, ISI policies ensured that no new dynamic export sector could emerge as an alternative source of government revenue. Continuation of the ISI policies was not of course unrelated to the rents that they generated. The impetus for liberalisation came when the resulting economic stagnation and consequent political pressures undermined the political support for the SLFP government, leading to the UNP victory in 1977.

But there was no pressing reason why structures of clientelism (that shaped party political machinery) should have disappeared. Political support for the new government, particularly in the rural areas, was still structured around patronage. It is in this context that the specific package of measures that comprised the economic programme of the government in 1977 has to be analysed. As we noted earlier, it had three components, of which two (the public sector investment programme (PSIP) and the consumer subsidy cuts) were not central to the liberalisation reforms. The PSIP was driven first and foremost by political imperatives. First, the government felt it needed to capture the public imagination to garner political support for its reforms. Many of their benefits inevitably had a long gestation period, whereas many of the costs (employment losses in previously protected industries or the inability to provide 'public goods and services' as had been the case in the past) were in contrast felt very immediately.

The PSIP helped bridge the gap. Second, it wanted to lock-in substantial donor aid for a long-term programme while there was still a wave of international goodwill about the opening up of the economy.42 Third, it wanted to generate employment and other sources of patronage. The PSIP promised large-scale employment for youth, land for the rural poor and the prospect of lucrative government contracts for business supporters. Fourth, the availability of lucrative government contracts and the general revitalisation of business confidence mitigated to some degree the adverse impact of liberalisation on the import competing industries in the private sector. The implementation of liberal economic reforms was thus accompanied, rather perversely, by a significant increase in the size and importance of the state sector in the national economy. The PSIP helped the new government retain bases of mass support in the rural areas, providing many supporters with employment in the building and construction activities associated with the programmes.

Many jobs were also provided in state economic enterprises, leading to gross inefficiencies, bloated wage bills and higher deficits that required government fiscal transfers. 43 But this was a short-term solution. In fact the government's decision to pursue the PSIP driven by political motives had a significant long-term cost because its macroeconomic effects worked against the development of sustainable employment growth. PSIP expenditure appreciated the real exchange rate and undermined the competitiveness of export-oriented industries (Athukorala and Jayasuriya 1994). It undermined incentives given to the tradeable sectors by the trade and exchange rate reforms.

These negative effects were, at best, only partially compensated for by benefits from expanded infrastructure and power generation because of the overall inefficiency of many of the component projects.44 With the employment impact of the PSIP slackening off by 1982/83, the ability of the regime to continue handing out largesse to its rural supporters waned. Economic growth was faster than in the pre-1977 period, but it was inadequate to meet the high expectations that had been generated. By the mid-1980s, large numbers of youth were unemployed, disillusioned and frustrated. Tambiah (1986:52) speaks of a "mass of a rootless and marginally employed population…in slums and bazaars, constituting a ready pool to be mobilised for instant payoffs". Available for hire to protect interests or foment trouble, every major party had thugs who could be organised, transported to wherever necessary in government vehicles (often accompanied by MPs) to serve its political interests.

Furthermore, from the very beginning of trade and macroeconomic policy reforms in the late 1970s, implementation of the reform agenda was essentially discriminatory -- albeit also highly complex. Ethnic and class dimensions were interwoven. Had trade liberalisation been 'across the board', then all previously protected industries would have lost out, and consumers and export industries would have reaped the benefits. But that was not the case. Trade liberalisation in practice was highly selective, and the criteria for this selection were essentially political.45 This applied not only to the industries affected, but also to the (uneven) provision of export subsidies. And the impact differed as a result -- reflecting the same political criteria.

For example, selective agricultural trade liberalisation adversely affected Tamil farmers of crops such as grapes, chillies and onions in the Jaffna peninsular, but it was not extended to paddy or potatoes grown predominantly by Sinhalese farmers.46 This indeed "became one of the grievances of the Tamils against the new government" (de Silva and Wriggins, 1994: 457). And yet, not all Tamils suffered. In the wake of the previous shortages, the immediate benefits of import liberalisation were widespread, and the urban middle class and those who controlled trade (including wealthy Tamil commercial interests) gained quite disproportionately.There was also other policies that affected Tamils in a discriminatory manner. The PSIP was strongly biased towards the non-Tamil regions.

Requests by the Tamils for the Mahaweli irrigation project to cover traditional Tamil areas was rejected and new settlers in the irrigation systems were overwhelmingly from the Sinhalese community. Tamils' access to new employment created through public investment programmes was substantially restricted both because of the Sinhalese language proficiency requirements for public sector employment and because they lacked political patronage. The overall package of policies that was implemented had strong ethnically discriminatory elements.

Growth of economical unrest and welfare expenditure

More generally, the policy package as a whole had an inegalitarian bias. In our view, it reflected the confluence of ideological, political and historical influences that had both domestic and foreign roots.**47** Changes that occurred in welfare expenditures are of particular interest, in the light of their role in human development outcomes as referred to earlier. Here it is important to make the point that there was no pressing economic rationale for linking cuts in welfare expenditures, the provision of a range of basic goods and services (food, health and education) much of it investment in human capital, to the broader trade and exchange rate liberalisation.**48** There was no immediate fiscal imperative; the budget deficit was expanding but at that time fiscal austerity was not driving policy.

Nor was there any study that could demonstrate rigorously that it was welfare expenditure, rather than the ISI policies, that was bore major responsibility for holding back Sri Lanka's growth. Nor were welfare expenditures and ISI policies necessarily linked: no developing country practising ISI -type strategies had a welfare programme that was the same as that of 'outlier' Sri Lanka.49 The primary motivation for the cuts was ideological and political. Wold organition, particularly the World Bank (that had long pushed for removal of consumer subsidies), found support in the government, in particular from the President. Dismantling the structure of 'welfare' expenditures thus became a key component of the policy reform agenda.The reason was the following. J.R. Jayawardene had, as Minister of Finance, made the abortive attempt to cut food subsidies in 1953.

With an unassailable position in parliament and the clear weakness of the left parties and trade unions, he saw a political opportunity that had eluded him for a quarter of a century, not just to cut consumer subsidies but, perhaps more importantly, to confront the trade unions and inflict crushing defeat on them. The government's main support base was in rural areas, not among urban wage earners. The PSIP targeted the government's political support base in the rural areas, and cuts to food subsidies by helping increase food prices also bolstered support among the rural farming community. The brunt of the burden of subsidy cuts would fall on low-income urban wage earners, traditionally supporters of left parties. It was almost inevitable, then, that these cuts would provoke a confrontation with the trade unions. However, the government's political agenda was only part of the wider ideological-political imperatives that drove cuts in the food subsidy.

The emphasis that was placed on them by the World Bank in particular can only be understood when seen in the broader context of its global policy agenda. Maintenance of consumer subsidies was anathema to neo-liberalist thinking that considered all forms of state intervention in markets to be inherently bad. According to this line of thinking, economic growth in developing countries was held back by too much state intervention, of which ISI policies were really only one facet. Consumer subsidies of any form appeared incompatible with required policy changes for rapid economic growth. Growth would, in this view, automatically lead to sustainable improvements in basic needs without the need for the direct public action advocated by economists such as sen.

Consumer subsidies that formed the core of basic needs provision oriented public programmes in Sri Lanka was thus caught up in a wider debate about the potential benefits and viability of alternative development strategies.50 In 1979, the universal rice ration that had guaranteed a basic measure of free rice to all consumers was converted to targeted food stamps for the poorest half of the population. High inflation in 1980-82 almost halved their real value (Central Bank 1983; Ravallion and Jayasuriya 1988). For some, adverse price changes may have been offset by new employment and/or by higher incomes, but for the vast majority they were not. Thus, in practice, the immediate impact of the liberalisation package and the government's other policy initiatives on the real incomes of the poor was at best quite mixed.

High inflation generated by the PSIP had the sharpest negative impact on those on relatively fixed incomes, such as workers in industries administered by wage boards and public sector workers.51 In July 1980, public sector employees, who had traditionally been organised in left-wing trade unions, tried to resist the cuts in their living standards through strike action. This was to prove another watershed in the political life of the country. Jayawardene, who had long considered trade unions a tool of the political left, had been preparing for the battle. In 1978, he had threatened public sector employees with dismissal if they participated in a one-day token strike called by leftwing unions (de Silva and Wriggins, 1994). In 1979, he had passed the Essential Public Service Act that gave sweeping powers to the government to outlaw trade union activities in the state sector.

The government was completely intransigent in its response to the strike: it refused to negotiate, ordered workers to return to work, and summarily dismissed thousands of workers who defied the order. Political opposition to these measures was brutally repressed. Troops were called out, strike-breakers from the pro-government trade union, Jathika Sevaka Sangamaya (JSS), used strong-arm tactics against strikers.52

Unions were also banned from the new export processing zones. With collapse of the1980 strike trade union activity that had characterised Sri Lankan political life since the 1930s was muzzled and seriously weakened, closing off what had hitherto been an important avenue of legal protest.53 This attitude towards unions was part of a pattern of increasing political centralisation and authoritarianism. It was reflected in the replacement of the Westminster style parliamentary system with a new Gaullist-type constitution with an executive presidency and minimum accountability to parliament, steady erosion of civil and electoral rights, high-handed treatment of ethnic minorities, a refusal to hold parliamentary elections and the subsequent extension of parliament through a referendum.

But the marked strengthening of political control and the impression that the government was omnipotent 54 were not just an expression of the undoubted weakness of the opposition, of Jayawardene's shrewdness and of his political persona (Moore 1990). They were inter-linked with the economic policies that were being implemented. Always an opponent of the left, he was firmly committed to reversing what, for him, had been fifty wasted years of welfarism and left liberal policies (Wijesinha 1991; de Silva and Wriggins 1994). He foresaw that change would engender, not simply friction but hard political conflict and he was determined to set up a system of political loyalty and centralised power that would make his vision reality. Jayawardene was committed to reshaping political institutions to ensure that the economic policies he was implementing could not be challenged or derailed in our society.

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