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Poverty of Economics in Economic Management: An Analysis of the 1995 Budget¹

Sumanasiri Liyanage²

'Would you tell me, please, which way I ought to go from here?'
'That depends a good deal on where you want to go' said the cat.

Alice's Adventures in Wonderland

The first budget of the Peoples' Alliance (PA) government was presented to Parliament on 8th February by the Minister of Justice and Constitutional Affairs, Dr G L Pieris. At the outset, two points related to the issue of popular democracy need to be emphasized. First, this is the second time that the budget was presented by someone who is not the Minister of Finance. The first time was in 1993 when the 1994 Budget was presented to the Parliament. The PA Government also has taken cover behind an unfortunate phrase in the Constitution of Sri Lanka that any minister could present the budget. As Mr Bernard Soysa correctly pointed out in his comment on the 1994 Budget 'the failure to follow the normal practice is yet another instance of the devaluation of Parliament and Parliamentary procedure' (1994:1). Secondly, in previous years, the estimates of government revenue and expenditure had been revealed well in advance of the Budget speech. This time the budget estimates for 1995 were submitted to Parliament only one day before the Budget. It makes the budgetary exercise a 'secret' affair, thus making it difficult for Members of Parliament to prepare for the budget debate.

The budget is not only an exercise in garnering revenue to finance the estimated expenditure in the coming year but is also an important statement of how the new government is going to steer the economy in the next six years. The 1995 Budget was looked upon by the business community as a statement which would translate the policy statement of the President into a concrete plan of action. Similarly, the people who voted for the PA in two elections expected that the government would take steps towards the fulfillment of their aspirations. However, the options open to the PA government are limited and the track on which it has to manoeuvre is narrow and difficult. Although the economy is growing at the rate of 5 per cent per annum, the economic fundamentals are not good. There is double-digit inflation. More than 14 per cent of the labour force are unemployed. In addition, about 100,000 young people enter the job market annually. The deficit of the current account of the balance of payment will be more than SDR 1,000 million (about Rs. 67,000 million) this year. At the end of 1994, the total public debt stood at Rs. 548,563 million. Though the external reserve was adequate to finance

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1. The first version of this article was presented at the Ceylon Studies Seminar. I wish to thank the participants of the discussion for their comments and Mr Krishnaraj Selvaratnam and Prof Y R Amarasinghe for constructive suggestions and editorial help.
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six months of imports when the PA government assumed office, the Minister has recognized that it is not adequate to protect the country 'from the vagaries of international trade'. This shows the vulnerability of the Sri Lankan economy to the vicissitudes of the global economy. The recent developments in Mexico clearly demonstrate the vulnerability of a third world economy in the present world context. How the PA government is going to address itself to problems faced by the Sri Lankan economy was indicated first in the President's statement to Parliament on 6th January and now in the Budget speech. In this article, I propose to examine critically the soundness of the overall economic strategy of the budget and the underlying assumptions. Section One will be a profile of the Sri Lankan economy. In Section Two, the budgetary strategy of the new government and its theoretical basis will be examined. This section will focus on the first three sections of the budget speech. The soundness of this strategy in relation to the short-term stabilization objectives of the economic policy will be discussed in Section Three. In section four, the implications of the budget on economic growth and employment will be examined.

1. A Profile of the Sri Lankan Economy after 17 years of Adjustment

Sri Lanka is one of the first countries in South Asia to adopt the liberalization policy package with the aim of achieving newly industrializing country (NIC) status. The phrase 'liberalization policies' is a short descriptive term which is used widely and also in this article as synonymous with 'open economic policies', 'free market policies' and 'outward oriented policies'. It was often argued with some justification that policy changes in 1977 were the result of pressure from the multinational financial institutions. But this argument ignores the significance of local developments during the period of the 'control regime' (1960- 1977) under which on the one hand a somewhat powerful class of local bourgeoisie had emerged which finding the control regime to be an obstacle to its further expansion, exerted pressure on politicians to adopt a more liberalized regime, and on the other hand, there was a consensus among people that the unresolved structural problems of the economy needed a change in the policy framework. Although the basic characteristics of the policy framework remained unchanged in the last 17 years, they have undergone significant changes in emphasis in the different phases of implementation³. The economic indicators in Table 1 show the mixed results of the economic administration of the last regime.

3. Three phases may be identified: (i) the formative period of stabilization, 1977 -83; (ii) the period of stabilization through deflation, 1983 -88; (iii) the period of structural adjustment, 1989 - (Liyanage, 1993: 13)

Table 1
A Statistical Profile of the Sri Lankan Economy

KEY RATIOS	1978	1985	1993
Gross Domestic Investment/GDP	21.3	23.8	25.8
Exports/GDP	33.9		22.6
Gross Domestic Savings/GDP		16.8	13.8
Trade Balance (deficit)/GDP	5.6	10.4	11.1
Trade Balance (deficit)/Exports	18.1		55.4
Total Debt/GDP	79.7	81.9	97.4
Foreign Debt/GDP	37.5	59.0	75.3
Debt Service/GDP			4.8
Debt Service/Export Earnings	15.5	21.0	13.7
Fiscal Deficit/GDP	18.8	18.6	8.1
Direct foreign Investment/GDP		0.5	1.8
GROWTH RATES			
GDP	8.2	5.0	6.9
Agriculture	4.2	8.6	4.9
Manufacturing	8.4	5.2	10.5
Exports	3.0	-8.0	17.0
Imports	63.0	5.0	15.0
Consumer prices	12.1	1.5	11.7

Source: Central Bank of Sri Lanka, *Annual Reports*, various years

Table 1 shows that many structural weaknesses of the Sri Lankan economy remain unresolved even after a 17 year period of structural adjustment. The average annual rate of growth of GDP which stood at 7 per cent between 1977 -1983 declined to 3.3 per cent between 1983 -1988. The economy, however, has started to rebound from this low level after 1990. The Budget Speech notes:

Growth in agriculture in the past has been weak, about 2.3 per cent on average during 1978 -1993 compared to 3.5 per cent in Indonesia, 4.4 per cent in Thailand and 3.5 per cent in the People's Republic of China. (Parliament of Sri Lanka, 1995: 16)

Although the performance of the industrial sector is relatively better than that of the agricultural sector, Sri Lanka still lags behind the more dynamic economies of the Asian region. While Thailand has recorded a 13 per cent annual growth rate between 1988 - 1994, industrial production both in Malaysia and the People's Republic of China grew at the rate of 12 per cent per annum. In Sri Lanka, the annual growth rate was 7.2 per cent between 1990 -93. Although the economic strategy in *toto* has been oriented towards an increase in exports, exports in Sri Lanka grew at the rate of 8 per cent on

average in the last ten years.

All economies in East Asia achieved their high growth performance through rapid growth in exports. The annual average growth in exports in Thailand during the last ten years was 21 per cent. Malaysia achieved 12 per cent growth while the People's Republic of China maintained a 16 per cent growth. (Parliament of Sri Lanka, 1995: 16)

While some of the structural weaknesses remain unresolved, new problems have arisen as a direct corollary of the open economic policies. This is clearly demonstrated by the key ratios in Table 1. Trade deficit as a percentage of GDP has increased from 5.6 per cent in 1978 to 11.1 per cent in 1993. There is no sign of bringing it back to its 1978 level in the immediate future. The 1995 Budget speech estimates that it will be 12 per cent in 1995. Total public debt as a percentage of GDP has risen from 79.7 per cent in 1978 to 97.4 in 1993. Although the foreign debt service ratio is at a manageable level, foreign debt as a percentage of the GDP has increased from 37.5 per cent to 75.3 per cent in 1993.

2. *The Budgetary Strategy*

The criticism of the policies of the existing regime provides the basis for the political parties which seek power to formulate the policies and strategies that they plan to adopt when they assume office. Consequently, these criticisms of the existing policies may also indicate the corrections which would be introduced by them to the existing policy framework. It is natural that the Minister of Finance, in presenting the maiden budget of the new government, uses significant part of his/her speech to examine critically the policies of the previous government, and to explain how the economic policies of the new government would differ from them. The Minister has devoted the first part of his Budget speech to examining 'the legacy that [the new government] inherited from the 17 year U[nited N[ational P[arty]-coalition administration'. However, the legacy of the past is not interpreted by the new regime as an outcome of an incorrect economic strategy. Rather the Minister argues that the policy framework of the UNP government was basically correct.

The dismantling of these controls and liberalizing the economy commenced slowly in 1977 and was accelerated after 1988. While these gave an immediate spurt to the economy, the previous regime frittered away a golden opportunity to galvanize the economy to new heights by the practice of fuelling unprecedented inflation through reckless government expenditures on grandiose ceremonies and conspicuous but inefficient projects. (Parliament of Sri Lanka, 1995: 5)

The Budget speech further states:

This type of expenditure accompanied by the enthronement of crony

capitalism in its most naked form, sapped the energies and incentives that were released by economic liberalization. (Ibid)

The inference is that without waste, corruption and cronyism, the UNP policy framework would have produced the expected results. The UNP policy would have produced better results if the UNP had been able to minimize these 'evils'. So what is necessary is to follow the same set of policies without the corruption and the grandiose ceremonies. This seems to be a simplistic explanation of the failure of the UNP policies to direct the country on a self-sustained growth path.

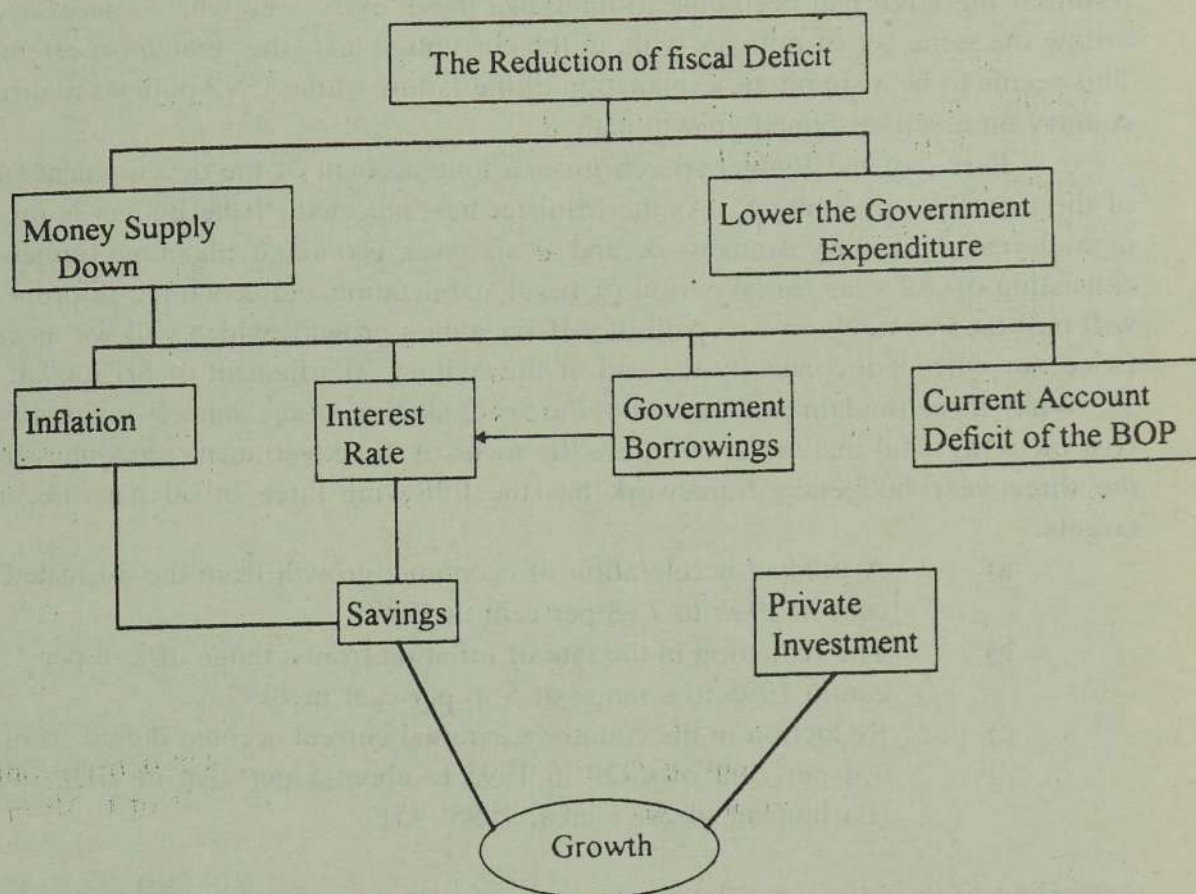
Part 2 of the Budget speech gives a long account of the development strategy of the new PA government. As the Minister has indicated, '[t]he Budget is presented in a 3-year budgetary framework and a six year economic planning framework, consisting of a 2 year initial period of fiscal stabilization and economic reforms which will pull the economy on to a path of self-sustaining growth, which will see us earning twice our current incomes by the end of the century' (Parliament of Sri Lanka, 1995: 1). While three fundamental aspects of the Sri Lankan economy namely unemployment, cost of living, and income growth, are the focus of the government economic strategy, the three year budgetary framework has the following three broad macro-economic targets.

- a) A gradual acceleration of economic growth from the estimated 6 per cent in 1995 to 7 -8 per cent in 1997;
- b) The reduction in the rate of inflation from a range of 7 -8 per cent in 1995 to a range of 5 -6 per cent in 1997;
- c) Reduction in the country's external current account deficit from about 6.4 per cent of GDP in 1995 to about 5 per cent of GDP in 1997. (Parliament of Sri Lanka, 1995: 45)

According to the Minister, 'the key to achieving macro-economic stability and to build confidence in our economy is prudent fiscal policy [because] persistently high budget deficits raise prices, drive up interest rates, reduce domestic savings, and take resources away from productive economic activities'. With this strategy, the government seeks not only to extricate the economy from the current 'mess' but also to raise the per capita income per month from the current Rs. 2,700 to Rs. 5,800 by the year 2000. In a small open economy, there are two fundamental stabilization objectives in any macro-economic programme, namely, (i) the reduction of the current account deficit of the balance of payments; (ii) the reduction of inflation. The short-term stabilization of the economy may be a necessary condition for medium and long-term growth but in itself will not ensure growth. Stabilization involves cost. Sau (1993) identifies two of them, namely (i) output loss, and (ii) exchange loss. So stabilization programme should take precautionary measures so that short term adverse effects do not leave permanent marks in the economy. Or in Sau's words, the possibility of 'hysteresis' effects involved in any short-term stabilization programme has to be minimized. Fiscal discipline is an essential aspect of any macro-economic strategy of stabilization. Nevertheless, it appears that there is an over-emphasis on this aspect in current economic discourse due to ideological reasons.

Figure 1 is a schematic presentation of the budgetary strategy. It shows how the reduction of fiscal deficit, through intermediate processes and mechanisms, would influence growth.

Figure 1: The Growth Strategy of the 1995 Budget



The PA government seems to believe that the insistence on the reduction of the fiscal deficit will produce four main results. First, it will reduce the rate of inflation since the main cause of inflation is viewed as the increase of money supply caused by the excessive borrowing of the government. Secondly, it will reduce the rate of interest because the lower the demand of the government for loanable funds the lower the demand pressure in the capital market. The lower rate of interest rate will in turn encourage more investment. Thirdly, the budget deficit will reduce the stock of public debt and debt servicing of the government. Fourthly, it will reduce the current account deficit of the balance of payments since the fiscal deficit is the principal cause of external imbalance. On the basis of this logic, the government appears to have assumed that the correction of the fiscal imbalance is the key to any stabilization and growth programme. So, the Budget speech does not even mention any specific measures aimed at correcting the current account deficit.

The government seems to assume that the correction of the fiscal imbalance and its anticipated outcomes will bring about long-term economic growth with a high level of employment. The Minister thinks that this 'beautiful dream' can be achieved 'if we are willing to face a short period of initial hardship needed to put our house in order'. The similarity of this policy framework to the policy framework of the UNP is obvious. Moreover, this policy framework is based on policy reforms advocated by the multilateral financial institutions. Along with fiscal discipline, the government has proposed that the structural reforms programme initiated by the last regime will be continued with certain safeguards to prevent corruption. This structural reform package includes customs reform, tax reform, the introduction of goods and service tax in place of the turnover tax and the public enterprise reforms (a new term for privatization). The basic thrust of the economic policies expounded by the Minister in the Budget speech seems to have been derived from the ideological position held by the WB-IMF. Prof Prabhat Patnaik aptly calls this perspective 'transcendental marketism' because 'the case for it is made on general principles (1994: 683). The main features of these reforms may be described as follows:

Structural reforms seeks to shift resources: (a) from the non-traded goods sector to the traded goods sector and within the latter from import competing activities to export activities; and (b) from the government sector to the private sector. Apart from resource allocation, structural reform seeks to improve resources utilization by; (i) increasing the degree of openness of the economy, and (ii) changing the structure of incentives and institutions, which would reduce the role of state intervention to rely more on the market place, dismantle controls to rely more on prices, and wind down the public sector to rely more on the private sector. (Nayyar, 1993: 641)

This framework includes certain positive aspects the strength of which is obvious particularly in the current world context which I shall consider in the fourth section of the paper. However, this policy framework raises many theoretical and substantive problems to which I shall turn presently.

3. Inflation and Trade Balance: Two Goals of Macro-economic Stabilization

If we can single out one objective in the Budget as the most fundamental one, it is certainly that of curbing inflation. The second stabilization objective, the correction of trade imbalance, seems to be put to the back burner on the assumption that the anti-inflationary measures will correct it in the process.

A fundamental requisite to achieve our saving-investment objective together with the full exploitation of growth potentials in agriculture, industry and service sectors, is the maintenance of price stability or curbing inflation. (Parliament of Sri Lanka, 1995: 17)

No one can deny the importance of curbing inflation as a short and medium term goal in macro-economic management. Nevertheless, this singleness of purpose has to be legitimized. So, the budget speech argues that inflation is 'the cruellest tax' on the poor.

Since the rate of inflation in Sri Lanka is well below 20 per cent, in the Sri Lankan context giving primary importance to the containment of inflation may also be justified by showing that all the other macro variables and micro behaviour of the economic agents are determined by this single macro variable, i.e., inflation. Let us for a moment assume that this presumption is correct. What causes inflation? The Minister's diagnosis is that '[d]uring the last two decades, Sri Lanka has failed to achieve price stability largely owing to high budget deficits'. This diagnosis as well as the medicine prescribed by the Minister seem to have based on the assumption that the inflation can be curbed through the reduction of the fiscal deficit. This assumption may be questioned on both theoretical and empirical grounds. Table 2 gives data on Sri Lankan inflation.

Table 2
Inflation in Sri Lanka

1951 -60	0.7
1961 -69	2.9
1970 -79	8.2
1980 -87	17.6
1988 -93	14.9

Source: Central Bank of Ceylon, Annual Reports (various years)

The monetarist explanation is that 'inflation is everywhere and always a monetary phenomenon'. The fiscal imbalance and government's borrowing are principally blamed for the increasing money supply. Does the Sri Lankan data support this proposition? Howard Nicholas who studied the phenomenon of inflation in Sri Lanka between 1971 and 1987 testing the monetarist and the structuralist hypotheses against the time-series data found that the Sri Lankan data did not support the monetarist view on inflation. He concludes:

The general conclusion which emerges from the present study is that structurally induced cost-push, relative price and demand-pull factors emanating from predominantly external impulses have had greater bearing on movements in the aggregate prices than autonomous monetary impulses. (n.d.: 4)

He further states:

The published data .. does not appear to provide much support for the existence of behavioural relations between money stock changes and the aggregate price level in the Sri Lankan economy over the period 1971 -87. .. The data appears to contradict the view that the major component of money stock expansion has been credit to the public sector. Or to put it another way, the Sri Lankan expansion does not appear to lend support to the view that inflationary pressure are brought about by excessive public sector borrowing. (Ibid: 33)

Nicholas also found that if there is any causal relationship between money stock and the aggregate price level, it is not from money stock to aggregate price level but the reverse. This is similar to the conclusions of many writers with different theoretical positions. For example, Deepak Lal (1985), a well-known neo-classical theorist, also comes up with the same conclusion when he says that 'most of inflation that Sri Lanka has faced since 1977 can be attributed to two [external] factors', namely foreign prices and the devaluation of the Sri Lanka rupee. The import content of production and consumption has increased significantly in the last 17 years so that the influence of foreign prices of imported capital, intermediate and consumption goods on Sri Lankan domestic prices became significant. This was further exacerbated by the continuous devaluation of the Sri Lankan rupee in relation to the currencies of major trading partners. Moreover, the constant increase in domestic prices makes further devaluation necessary in order to preserve and maintain the competitiveness of our exports. The unrealistic and unjustified emphasis on the fiscal deficit in controlling inflationary pressure may not produce the expected results. This will also have adverse implications. An experienced observer who is sympathetic to the new economic policies in India has given the following warning:

Inflation is essentially the result of a struggle between different sections of the community for a larger share in the national cake that what others are prepared to surrender; and its outward manifestation generally is an excessive supply of money. Too much attention to the medium -that is money supply - can divert attention from the underlying forces; and hence concepts like budgetary deficits, however defined and however important, should be used with care and not as simple or single yardsticks. (Patel, 1992: 42)

The question of inflation may be viewed from another angle. Curbing inflation is often described as a panacea for all economic ills. According to this line of thinking, the problem of inflation should be dealt with at any cost because the price stability would ensure a high level of savings and investment and any move away from this target may lead to a cumulative departure. However, this issue should be viewed with care and the measures to curb inflation have to be selected carefully. In an economy in which a substantial amount of resources is not utilized or is under utilized, anti-inflationary policies may produce more adverse results. As Dornbusch writes:

On the issue of inflation targets, pragmatism prevail. Central bankers should talk about zero inflation, but they also should compromise with reality. At the margin there are trade-offs, and pushing zero inflation at any cost is not only socially irresponsible but also bad economics. (1991: 22)

I shall now turn to the second objective of any macro-economic programme, namely the external balance. In this respect, it is essential 'to pre-empt a collapse of the balance of payments situation in the short term and to reduce the current account deficit in the medium term' (Nayyar, 1993: 640). In correcting the current account imbalance, attention should be paid to achieving equilibrium in the trade balance. According to the

budget speech, the trade deficit is estimated to rise from SDR 825 million in 1993 to SDR 1,062 million in 1994. This will lower the overall surplus of the balance of payments in 1994. The trade deficit estimated for 1995 is SDR 1070 million, marginally higher than the projected deficit in 1994. The monetary approach to the balance of payments views the trade deficit as a reflection of excess demand in the domestic economy. As a widely-used text book in macro-economics puts it, '[this] analysis implies that a persistent deficit on the BOF [Balance of Official Financing] must be the result of continuous domestic credit creation by the central bank. This will occur either in the process of sterilizing the deficit or through the central bank's direct financing of a government's budget deficit together with sterilisation of the BOF deficit' (Levacic and Rebmann, 1982: 182). The prescription given by the multilateral financial institutions to correct the external imbalance is to contain the fiscal deficit and to extend and expedite trade liberalization with the hope that imported cheap capital and intermediary goods would facilitate export production. The argument is that while the former will reduce the domestic demand pressure emanating from the budget deficit the latter will improve efficiency in resource utilization which will make the country's exports internationally competitive. The Budget speech appears to have unhesitatingly followed this logic. Thus import duties on many items have been slashed. Already some industrialists have expressed their concern regarding duty reduction on certain goods such as bicycles, textiles and apparel, tyres and tubes and food items because of the possible adverse implications for local industries. The minister attempts to justify it on the grounds that the reduction of import duties would lower the domestic prices and, hence, the cost of production thus facilitating an export production. There is some truth in this argument. Nevertheless, certain complexities would also enter into the equation which may produce different results. Lower tariff rates may lead foreign suppliers and their local agents to increase the price of imports. Nambiar and Mehta observed, in the light of the Indian experience, that the foreign prices of imported goods 'tend to be high when tariff rates are low and when tariff rates are high, prices relatively tend to be low' (quoted in Sau, 1993). If this is the case, the import bill will rise because of the increase in volume and price.

Moreover, the causal link between the fiscal deficit and the external imbalance is also problematic. The domestic demand pressure leading to a high level of imports is not merely a result of the fiscal deficit but is also an outcome of increasing expenditure of the people, particularly of those with high incomes, on imported goods and services. Therefore, if the reduction of the fiscal deficit is offset by an increase in private expenditure, the external imbalance will persist. In the budget proposals, there are no specific measures for the reduction of unproductive private expenditure.

4. Medium-Term Prospects on Growth and Employment

The economic growth and development of an underdeveloped country cannot be designed in isolation. In the 1960s and 70s, the popular notion was that the world system dominated by the centre countries of the first world deliberately blocked the development process of the developing countries in Asia, Africa and Latin America. Therefore, economic development necessitated 'delinking' from the world system. Coupled with

this was the view that the state should play the dominant role in the development effort. In practice these two propositions did not produce the intended results and most of the developing countries which followed the strategy based on these ideas continued to remain underdeveloped and poor. In many instances, the situation in some countries had worsened. As the theoretical weakness of these popularly held views have been discussed by many analysts, there is no need to repeat them here. On the other hand, countries which adopted a different economic strategy, were able to develop their economies and emerge as the NICs. Any national economic policy, in the present world context, should recognize two important principles, namely that (i) the developing countries have to integrate their economies with the international economy in many ways, and (ii) the market mechanism works much better than the populist notion had posited. The acceptance of these two principles will not mean that the systemic problems of the world system have now disappeared. Nor does it mean that there are no systemic errors in the market mechanism. However, any realistic national economic strategy should take into consideration all these factors when the national economic policies are designed.

The economic policies of the PA government as manifested in the 1995 budget speech take these principles as a point of departure. But it appears that its policy-makers following the advice of the multilateral financial agencies have raised these two principles to the level of an ideology. Hence the PA government's economic strategy seems to have based on an ideology rather than a realistic assessment of the international situation. I have discussed this aspect in the previous section in relation to the stabilization objectives. But this will become more obvious when the government's medium term objectives of income growth and employment creation are considered. According to Dornbusch, '[a]djustment is a necessary, but not necessarily a sufficient, condition for resumption of growth, because asset holders may postpone repatriating flight capital, and investors may delay initiating projects'. He also notes that 'these factors raise an important problem of coordination that classical economics does not recognize' (1991: 19). The 1995 budget speech outlines how the government intends to move in order to achieve a higher rate of growth of GDP and generate more employment. It emphasizes the need to raise investment from the present 24 per cent to 30 per cent of GDP over the next several years. This requires an increase of domestic savings which is now at 14 per cent of the GDP. The projections for 1995 are given in Table 3.

Table 3
Projections for 1995

	1994	1995
GDP growth rate	5.5	6.0
Investment/GDP	26	24
Manufacturing sector growth rate	9.0	10.0
in which factory sub-sector	9.0	11.0
Agriculture growth rate	3.0	4.0
Tea (million kgs)	243	250
Rubber (million kgs)	108	110
Coconut (million nuts)		2750
Paddy (Million metric tons)	2.65	2.70
Construction growth rate	6.0	7.0
Tourism growth rate	2.4	2.5
Rate of inflation	10	8.0
Total exports (SDR million)	2207	2501
Total imports (SDR million)	3269	3571
Trade deficit/GDP	13	12
Net private transfers (SDR million)	442	486
Official transfers (SDR million)	115	120
Current account deficit (SDR mn.)	584	554
Official loans (SDR million)	138	260
Direct Foreign Investment (including portfolio) (SDR mn.)	131	160

Source: Parliament in Sri Lanka, 1995

I shall now examine how and to what extent the budgetary strategy would help to achieve the objectives of growth and employment. As the Figure 1 shows, it was expected that the reduction of fiscal deficit would bring about a fall in the rate of interest which in turn will encourage private investment. This depends on two elasticities, namely the responsiveness of the interest rate to the changes in fiscal deficit, and interest elasticity of investment. The interest rate under this strategy is not under the control of local policy makers. The interest rate was kept at a very high rate for many reasons. The high interest rate is an important aspect of the financial liberalization programme propagated by the multilateral financial agencies. It was argued that a high rate of interest would encourage savings, contain the demand for funds and discourage low quality investments, and will be anti-inflationary. Besides, the interest rate has to be fixed at a higher level in order to attract foreign short-term capital. Because, it is argued that a high interest rate would result in the piling up of foreign exchange reserves through the short-term capital movements when other factors remain intact. As Patnaik (1994) has pointed out this situation will present the government with a real dilemma. On the one hand, if the monetary authority reduces the interest rate, there will be an outflow of foreign short term capital. On the other, if it keeps the interest rate high,

there will be a real appreciation of currency due to piling up of foreign exchange reserves which may have adverse effects on exports and the trade balance precipitating a balance of payments crisis. Even if the government chooses to do nothing, there will be no escape. As Patnaik has shown, this will lead to a stock-market boom under a so-called market-friendly regime. So the government may become impotent in influencing the interest rate structure in this set up. In this context, as an outcome of the reduction of fiscal deficit, a fall in the rate of interest will be highly unlikely. This was recently demonstrated when the state banks lowered their lending rate in some sectors in response to the appeal made by the government, the private banks have refused to do so. The high rate of interest will adversely affect the investment decisions in general and the investment decisions of the small entrepreneurs in particular. It may also affect the construction of houses for personal use.

As Nayar (1993) has pointed out, the IMF-WB structural adjustment programme is concerned mainly with the supply-side of the economy. This is also the case with the 1995 budget. These institutions propose demand-side management through fiscal and monetary discipline in order to stabilize the economy. However, there is no synchronization between the demand-side adjustment and the supply-side adjustment.

The fundamental problem of transition arises from the fact that the speeds of adjustment on the demand side and on the supply side are considerably different. ... [t]he speed of adjustment on the demand side is fast. On the other hand, the speed of adjustment on the supply side is inevitably slow, particularly in economies characterized by structural rigidities where resources are not easily mobile across the sectors or perfectly substitutable in uses. This is so even if all the price incentives of a market economy can be brought to perfect function. Supply adjustment typically requires structural change through creation of capacity, alleviation of infrastructural bottlenecks, streamlining of input supplies, creation or reorientation of public utilities, and so on, all of which take time. The fast dynamics of demand and slow dynamics of supply have ... major macro-economic implications. (Nayar, 1993: 641)

These important issues seem to have been ignored in the budgetary strategy. The government's decisions not to engage in large capital projects would definitely make the supply-side adjustment more difficult and slower. The reduced demand of the government may lead to a further reduction of output particularly in the private sector. The empirical evidence particularly in the late 1970s and the early 80s shows that the public sector investment in fact crowds-in private investment. This is the experience of South Korea and Taiwan. The confidence of the private sector which the government seems to think as crucial, is a function of the level of economic activities. If there is sluggishness in the private sphere of the economy, it cannot be overcome by an economically inactive government with a defeatist line of thinking. Robert Wade (1990) in his excellent book on the role of the government in East Asian development has shown how the government played a 'big leadership' role in those countries. Public investment has in fact increased in the high performance Asian economies (HPAEs). A recent

publication of the World Bank reports:

In the 1970s overall levels of public investment did not differ markedly between the HPAEs and other developing economies; during the decade public investment rates in all economies rose from about 7 to 10 percent. But during the 1980s the HPAEs and other developing economies diverged. In other economies, the fiscal contraction of macroeconomic adjustment was reflected in lower public investment rates. In HPAEs, conversely, public investment shares actually rose between 1979 and 1982 and then remained at a level nearly 4 percentage points above their 1970s average. . . In short, in striking contrast elsewhere, public investment in 1980 -87 in these East Asian economies was counter-cyclical to the reduction in private investment. (World Bank, 1993: 43)

The high level of capital accumulation, increased allocation efficiency, and the productivity gains invariably contribute towards the achievement of high growth rate in GDP. In most HPAEs, the state played a crucial role in improving these contributory factors. The Malaysian government was initially involved in investment in heavy and chemical industries. The private sector, both foreign and local, has been looking at the new government from the time it assumed office. Although its commitment to the private sector-led development has been reiterated, the government is not yet able to win the confidence of the private sector. This is crucial because the budget speech clearly indicates that the government is planning to move away from its traditional domain of infra-structure development. The inadequate private investment both local and foreign is often attributed to the poor infra-structure facilities. The government is inviting private investors to enter this area. Since these investments are invariably large and expensive and their returns spread over a long period, is it realistic to think that private investors would invest in these sectors particularly at the present conjuncture?

All these trends may make the realization of growth targets for 1995 difficult. The situation on the employment front appears to be more serious. The Budget speech says:

Prospects for increased employment in the public sector are not encouraging, because employment in this sector has reached saturation point. Because of the large number of employees in this sector, even with a low salary structure, the government has to spend nearly 1/4 of its current expenditure on salaries -a very high burden. The private sector, unlike the government sector, can expand rapidly under good incentives and can create highly gainful employment through high investment and production. Also the Government will be encouraging self-employment under the Samurdhi Programme. (Parliament of Sri Lanka, 1995: 14)

As mentioned earlier, the main focus of the 1995 budget is the reduction of the rate of inflation. The generation of employment appears to be viewed as a necessary by-product of the anti-inflationary strategy. In my view, this is the Achilles' heel of the government

strategy. Anti-inflationary strategy is flawed due to two reasons. First, even if the budget strategy works as intended, steps should be taken to solve the mis-match between the available skill and the required skills. This calls for a complete change in our education system which is biased towards the arts and humanities and oriented towards the requirements of the public sector. The government accepts the need for this. But, the necessary funds have not been allocated for re-training, improvement of the quality of education, and new skills development. The total estimated expenditure of the Ministry of Education and Higher Education remains almost unchanged when adjusted to inflation. Resources allocated to other ministries for similar purposes are also not adequate. Secondly, will the budgetary strategy in operation generate adequate employment opportunities? This is also problematic. When unemployment and under-employment have become persistent problems, past as well as contemporary experience shows that deliberate policy measures are required to overcome it because growth in itself may not generate employment opportunities to absorb the available labour. This may be revealed by the fact that the high level of employment opportunities created between 1977 -82 in Sri Lanka was not an outcome of the stabilization and structural adjustment programme but a result of the high level of public investment in infrastructure development. According to the survey conducted by the Department of Census and Statistics, 175,000 to 200,000 employment opportunities were created during this period. The employment elasticity of output growth may vary in different sectors. As Adelman argues, the sectoral mix of output has implications for substitution of labour for capital. She argues that the employment elasticity of the industrial sector is typically very much lower than the employment elasticity of the agriculture and service sector. (see Edwards, 1993) Stern (1994) suggests that employment created by major construction programme initiated by the government accounted for nearly half the total employment increase during 1977 -83. So, the creation of employment requires positive intervention directly or indirectly by the state in determining the sectoral mix in the process of growth.

Conclusion

The PA government, in the 1995 Budget, has failed to address the crucial issues of the Sri Lankan economy. The government seems to have taken up a defeatist position assuming that it will not be able to articulate an independent national development strategy at the present historical conjuncture. In my view this is incorrect. The government has to rethink its economic strategy by re-reading the real experience of the East- and South East- Asian countries and fulfilling its election promise of economic development with social justice and democracy. As Blinder and Blank (1986) have shown, the poor suffer more under unemployment than they do under inflation. Adam Smith related economic growth and development with the increase in productive employment thus emphasizing the fact that growth and employment are overdetermined in the development process. In an employment-oriented economic strategy, some elements of the current stabilization and structural adjustment programme, acquiring a new meaning, will definitely play an important and useful role.

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Conditions that Contributed to the Origin and Development of the Political Violence Movement (P.V.M) in Sri Lanka: The Case of the Janatha Vimukthi Peramuna (JVP)

Gamini Samaranayake

INTRODUCTION

The political evolution of Sri Lanka since independence has been marked by general strikes as in 1947, 1953, 1981, ethnic riots, as in 1956, 1958, 1977, 1979, and 1983, and insurrections. Of these incidents of violence, insurrections, have posed a formidable challenge to the political system in Sri Lanka since the beginning of the 1970s'. These insurrections have varied in its origin and forms. There have been insurrections motivated by a need to make revolutionary changes in the socio-economic and political structure and in the related institutions. The insurrection of April 1971 and the violence waged from 1987 to 1989 by the *Janatha Vimukthi Peramuna* (JVP) or the People's Liberation Front represented the above mentioned violence. Some of it has been either associated with or resulted from the separatist ethno-nationalist movement. The separatist guerrilla war waged by the LTTE in the northern and eastern provinces since the mid 1970s has been an example of this category. The crux of this political violence is the struggle between the forces that endeavor to preserve the status quo and those which urge revolutionary or separatist change. On the whole it may be said that the political violence which has characterized Sri Lanka's political processes since the early 1970's is a manifestation of a crisis that is inherent in the country's political and socio-economic structures.

The main objective of this paper is to examine the causes that contributed to the origin and development of the left-wing political violence movements in Sri Lanka, theoretically and empirically. In order to examine the causes that led to the origin and development of a left-wing organization such as the JVP the paper is divided into three sections. The first part deals with the origin and development of the left-wing organizations and insurrections. The second part briefly examines the main elements of Huntington's theory of modernization. The third deals with socio-economic and political changes which are deemed as causes which contributed to the origin of a political violence movement while the final part draws conclusions based on the analysis.

Left-Wing Organizations

The mid 1960s were marked by a proliferation of underground left-wing organizations in the politics of Sri Lanka. The main organizations were, the *Gini Pupura* (Iskra) group, the *Peradiga Sulaga* (East Wind) group, the *Sumith Devinuwara* group, the *Janatha Vimukthi Peramuna* (JVP), and the *Revolutionary Communist League* (RCL). The first three organizations were splinter groups of the pro China Communist Party led by N. Shanmugadasan, while the last was a break-away group from the Trotskyite Revolutionary Lanka Sama Samaja *Paksaya* (RLSSP). The proliferation of such groups led to keen competition amongst them for supremacy in the sphere of left-

wing insurrections in Sri Lanka. In spite of the competition for hegemony, however, these groups shared three common factors: the first was the common objective of achieving socialism, the second was their opposition to parliamentary government and to the established left-wing parties, and finally their perception that a revolutionary struggle was the only means of achieving state power. The socio-economic crisis and political background in the 1960s led to the origin and development of left-wing organizations in the country. Of these groups the JVP emerged as the most significant and politically active group that was capable of attracting a wider membership. Although the other groups were equally attractive politically, they were less insurrectionary oriented.

As mentioned-above the JVP, popularly known as the Che Guevara movement was initially a breakaway group from the pro Chinese Communist Party (CPC) in the mid 1960s. It was basically, based among the rural Sinhalese-Buddhist youth. The ideology of the JVP is eclectic, with a mixture of Marxism, Maoism and Sinhalese ethno-nationalism. However, the JVP is more an action oriented organization than a theoretical oriented one unlike to the traditional left-wing parties. Besides, the JVP has remained largely a clandestine and quiescent organization.

The main objective of the 1971 insurrection was to capture state power through the strategy of a one-day armed struggle. It is a blue print of a strategy of an armed insurrection staged in Zanzibar in 1964. The insurrection of 1971 began with widespread armed attacks on nearly 100 police stations on the 5th of April. These attacks resulted in the capture or abandonment of 49 rural police stations, which comprised one-fourth of the police divisions in Sri Lanka. However, guerrilla action which took place in the countryside of the North Central, Sabaragamuwa and Southern provinces, did not affect the urban areas. After three weeks, the insurrection was thwarted and the government reinforced its position. Official statistics of the number of deaths was 1200, while non-government sources estimated it to be nearly 10,000.

After 1971 the JVP went underground and re-surfaced only after the elections of 1977. During this period the JVP went through a number of ideological and political changes. The most important of these changes was their entry into the process of electoral politics. At the General Election in 1977 the JVP contested four seats, and subsequently it fielded candidate at the Anamaduwa by election of 1978 and the Colombo Municipal Council Election of 1979.¹ Furthermore the JVP contested the District Development Council (DDC) elections in 1981 and the Presidential election in 1982. However, after the ethnic riots in 1983 it was proscribed by the government once again. Since then it went underground renewing its commitment to armed insurrection.

The Indo-Sri Lanka Accord in 1987 and the presence of the Indian Peace Keeping Force (IPKF) contributed to the second insurgency of the JVP. The objectives of the JVP's insurrection were as follows: the immediate expulsion of the IPKF from the island; abrogation of the Indo-Sri Lanka Accord of 1987; abolition of the provincial council system; holding of fresh elections and the dismantling of para-military forces

¹ The four electoral seats are as follows: West Anuradhapura, Horowpathana, Devinuwara and Kaburupitiya.

allegedly backed by the state. In order to achieve its objectives, the JVP unleashed a campaign of violence against the police and other armed personnel, state-officials, politicians from both the governing party and from the opposition and their supporters, and civilians. The insurgency was crushed by the government forces by using counter violence which resulted in over 10,000 deaths and the imprisonment of 14,000 members of the JVP. The movement as a result had gone underground until the general election in 1994.

Modernization and Political Violence

Since the early 1960s the growing incidents of political violence and subsequent interest of the phenomenon has resulted in the formulation of numerous theories in this field. Of these theories on political violence the modernization theory of S.P. Huntington has taken the politico-economic perspective.² Huntington seeks to examine the process of political violence in terms of social and economic changes and political underdevelopment or decay. In his classic study "*Political Order in Changing Societies*" published in 1968 he observes the following predominant trends in most Asian, African and Latin American countries since the Second World War: conflict based on ethnicity and class; recurring incidents of riots and mob violence; the spread of corruption among those in authority and power; the violation of the basic rights of citizenship; the curtailment of the powers of the legislature and courts; and the fragmentation or disintegration of mass based political parties. The possible impact of these trends on the political sphere include, *coups de'etat*, revolutionary violence, insurrection, guerrilla warfare, tribal or communal tension and dictatorship.³

According to Huntington, these conditions of political violence and instability are largely attributed to the "rapid social change and the rapid mobilization of new groups into politics coupled with the slow development of political institutions".⁴ Social mobilization in its broadest sense is a result of some of the basic changes in social development. Literacy, education increased communication, mass media exposure and urbanization, which are the main causes of social mobilization result in changes in the values, attitudes and expectations of a traditional society to those of a modern society.⁵ Such changes give rise to new aspirations and hopes and widen the sphere of political activity. The non-fulfillment of these hopes and aspirations widens and strengthens political participation and consciousness. Since, social change undermines the traditional political authority, it becomes necessary for political development to accompany social

² Modernization is defined as the process of transition from the traditional to modern principles of social organization.

³ S.P. Huntington, *Political Order in Changing Societies*, New Haven, Yale University Press, 1968, p. 3.

⁴ *Ibid*, p. 3.

⁵ *Ibid*, p. 33.

change. However, when political organization and institutionalization is low, the potential for political disorder and instability is high.⁶ Accordingly, "in the absence of strong and adaptable political institutions, such increases in participation means instability and violence".⁷

Thus social mobilization is a vital aspect of modernization which, when combined with economic development, has implications for political development. Huntington perceives that economic development is a channel which satisfies the aspirations generated by social mobilization and reduces the frustration in society. The operation of these variables increases the rate of frustration beyond the level of demand which the rate of economic development can fulfill. Although the scope of political participation is widened, it leads only to further frustration because the political system is overloaded with demand. Greater social mobilization, economic development and political participation thus undermines the traditional institutions and attitudes of society by creating heightened aspirations and hopes which the system is unable to fulfil in the short-term. Therefore, what creates political instability is the lack of political institutionalization which can accommodate such an expansion. In this context, political violence is the extreme case of the expansion of political participation.

Huntington's interpretation of this, is that when modernization occurs more and more people become politically active, because increased social mobility leads to raised expectations which at an early stage of economic growth cannot be met. Economic growth also leads at first, to heightened inequality which also prompts greater political participation. Unless political institutions are capable of handling this expanded participation, it will assume destabilizing forms such as demonstrations, strikes, riots or even armed struggle.

Huntington claims that by the 1960s every third world nation was subject to the process of modernization and the causes of political violence in these states lay within this process.⁸ He argues that the relationship between the degree of democratization and the likelihood of political violence is a linear one. In order to understand the causes behind the origin and development of the JVP and political violence in Sri Lanka the next part of this paper pays attention to the variables of social mobilization, economic development and political development and participation which paves the way for political violence movements in Sri Lanka in a more comprehensive manner.

Social Mobilization

According to Karl W. Deutsche, social mobilization is a name given to an overall process of change, within a substantial part of the population in countries which

⁶ *Ibid* p.5.

⁷ *Ibid*, p. 47.

⁸ *Ibid*, p.3.

are moving from traditional to modern ways of life.⁹ Social mobilization as it occurred in Sri Lanka will be discussed from the following aspects: growth of population and urbanization, educational expansion, expansion of non-agricultural occupations, literacy and the mass media.

The rapid growth of population in Sri Lanka was the most significant development following the Second World War. This was attributed to the high fertility rate and the declining death rate brought about mainly by the expansion of health and welfare facilities since mid 1940s. The death rate per 1000 people dropped from 20 in 1949 to 14 in 1956. From then on, the death rate gradually declined to 8 per 1000 in 1971. On the other hand, the life expectancy at birth rose from 43 years in 1948 to 66 years in 1971. Consequently, the population growth within Sri Lanka increased rapidly from 1901. The average annual rate of population growth for the period 1901 to 1946 was 1.3 per cent compared with the period 1946 to 1971 when it was 2.3 per cent.¹⁰ However, successful family planning measures led to a sustained decline in birth rates and large scale emigration has confined the growth rate to 1.5 percent a year. Sri Lankas' life expectancy at birth was 67.6 in 1981 with a female life expectancy of 72.1 years and a male life expectancy of 67.9 years. The infant mortality and neonatal mortality rates have steadily declined. The infant mortality rate which was 34.4 deaths per 1000 births in 1980 has declined to 19.4 by 1988.

A noteworthy feature of this demographic expansion is the distribution of population. Statistics on population growth reveal that a large proportion of the population was concentrated in the rural sector whereas the population growth in the urban sector was relatively slow. The 1981 census showed the population in the urban sector to be 21.5 per cent of the total population. Such limited growth in the urban population is to be attributed mainly to a natural increase within that sector rather than to migration from rural areas. Another significant phenomenon was the high percentage of youth in Sri Lanka's demography after the Second World War. In 1946, the numbers between the ages 15 to 24 stood at 1.3 million but by 1971 it had doubled to 2.6 million. Hubert Muller views such a rapid escalation in the youth population as providing potential cadres for youth movements and revolts.¹¹ Besides, a high proportion of youth in the demography of a country means that a large segment of the population requires access to education and employment.

The rapid expansion of education is another means of social mobilization. The introduction of free education from primary school to university in 1945, and the use of the vernacular or "swabasha" languages were partly responsible for the expansion of

⁹ Karl W. Deutsche, "Social Mobilization and Political Development", *American Political Science Review*, Vol. 55, 1961, p. 493.

¹⁰ Gavin W. Jones and S. Selvaratnam, *Population Growth and Economic Development*, Colombo, Hansa Publishers, 1971.

¹¹ Hubert Muller, "Youth as a Force in the Modern World", *Comparative Studies in Society and History*, Vol. 10, 1968, pp 237-260.

enrollments in schools. The periods between 1945 and 1970 saw an escalation of primary and secondary school enrollments from about 867,000 to 2,717,000.¹² The expansion of primary and secondary education was followed by a rise in the number of university entrants, when university education was open to students who needed instruction in the Sinhala and Tamil languages since 1959. In addition, the number of universities increased from one in 1942 to four in 1970. In 1979 the number of universities increased up to eight. Consequently, the number of students seeking admission increased from 1,612 in 1948 to about 14,000 in 1970.¹³

Education along with literacy kept expanding steadily after 1945 in Sri Lanka. In 1901, 8.5 per cent of the female population aged 5 years and over were literate as compared to the male population of which 42 per cent were literate.¹⁴ The figures for 1971, on the other hand, depict the growth of literacy to 70.7 per cent females about 10 years and over 85.2 per cent of males.¹⁵ The generation which was reaching adulthood around 1970 had achieved significantly higher levels of educational attainment than the previous generation.¹⁶ Furthermore, advancing social mobilization is obvious in the spread and coverage of the mass media. The number of licensed radio sets in Sri Lanka expanded from 10,000 in 1941 to 90,000 in 1945 and 405,000 in 1965.¹⁷ By 1971 the number had surpassed 467,000.

Although industrialization is usually an important variable in the process of economic modernization, it has little or no bearing on the modernization process in Sri Lanka. Prior to independence there was no industrial sector beyond the activities relating to the plantation economy only. A few important factories had been established in the private sector before 1939, a cotton mill, a tile works, two match factories, two distilleries and a few engineering establishments. Up until 1959, however, there was no

¹² Robert N. Kearney, "Democracy and Stresses of Modernization in Sri Lanka", *Journal of South Asian and Middle Eastern Studies*, Vol. 1, No. 3, 1978, p. 89.

¹³ G. Uswatta Arachchi, "University Admission in Ceylon: Their Economic and Social Background and Employment Expectations", *Modern Asian Studies*, Vol. 8, 1974, p. 290.

¹⁴ Department of Census and Statistics, *Statistical Abstract of Ceylon, 1967-69, 1970*, p. 35.

¹⁵ *Statistical Pocket Book of Sri Lanka*, 1973, p. 15.

¹⁶ Robert N. Kearney, "Politics and Modernization", in Tissa Fernando and R.N. Kearney, (eds) *Modern Sri Lanka: A Society in Transition*, 1979, p. 72.

¹⁷ N.D. Jayaweera, "Mass Media I, The Radio", in *Education in Ceylon: A Centenary Volume*, Part 3, 1969, p. 1217.

concerted drive towards industrialization.¹⁸

According to Ted Robert Gurr, that expansion in education and literacy heightened expectations.¹⁹ A similar tendency seems to be evident among the students who received a secondary or higher education and aspired to "white collar" jobs which paid better salaries and were urban-based. A survey conducted in this sphere revealed that youth who had completed their secondary and higher education sought administrative, clerical or teaching jobs.²⁰ A survey among university students revealed that 87 per cent desired public sector employment, 10 per cent private sector employment and 3 per cent self employment.²¹

Education had previously proved to be a stepping stone to white collar employment. Therefore, the young people who completed their education after job opportunities had been narrowed still had the high expectations which had been fulfilled earlier. A survey in 1968 found that 76 per cent of all those between the ages of 15 and 24 years who had completed the G.C.E. (O/L) and had not previously been employed sought white collar jobs.²² Moreover, a high demand for clerical employment among young people with secondary education was found in three separate surveys conducted between 1968 to 1971.²³

As a result of high social mobilization, aspirations among youth increased rapidly. Therefore, a high level of economic development is necessary to meet these high aspirations and expectations. According to Huntington, economic development which increases the capacity of a society to satisfy those aspirations therefore, should tend to reduce social frustrations and the consequent political instability.²⁴ In order to understand this correlation it is necessary to examine the economic development of Sri Lanka.

¹⁸ N.H.S. Karunatilake, *Economic Development in Ceylon*, New York, Praeger Publishers, 1971, pp. 176-177.

¹⁹ Ted Robert Gurr, *Why Men rebel*, Princeton, Princeton University Press, 1970, p. 96.

²⁰ G.Uswatte Aratchchi, "From Highway to Blind Alley: A Note on Youth and Higher Education", *Marga*, Vol. 1, No. 3, 1973, p. 148.

²¹ International Labour Organization, *Matching Employment Opportunities and Expectations: A Programme of Action for Ceylon*, 1971, p. 148.

²² *Ibid*, p. 33.

²³ R.K. Srivastava, and S. Selvaratnam, "Youth Employment in Ceylon: Problems and Prospects", *Marga*, Vol. 1. No. 4, 1972, pp. 43-44.

²⁴ S.P. Huntington, *op.cit*, p. 49.

Economic Development

From an economic perspective, Sri Lanka is one of the least developed countries in the Third World. The basis of the economy since the colonial period has been import-export oriented, based first on coffee then on tea, rubber and coconut. Between 1948-49, 63 per cent from tea, 17 per cent from rubber and 10 per cent from coconut contributed 90 per cent of the merchandise export earnings. Between 1971-72, the proportions were almost the same.²⁵ Both the prices of exports and imports are determined by external conditions and are subject to wide and unpredictable fluctuations. As a result, during the Second World War and the Korean War, Sri Lanka accumulated large sterling balances. Between 1960-70, however, the prices of tea and rubber which accounted for approximately 80 per cent of the export earnings, declined by 30 per cent and 40 per cent respectively.²⁶ While the income from exports declined, after 1960 import prices rose considerably. Consequently, after 1960 there was a growing balance of trade deficit. The deficit rose steadily from Rs. 95 million in 1965 to Rs. 328 million in 1966 and to Rs. 627 million in 1969.²⁷

Economic development may be less important than the degree to which economic benefits are distributed equally. However, the worsening economic situation in the 1960s indicated the disparities of income distribution and the widespread poverty levels. A survey in 1963 indicated that 84.14 per cent of the workers received salaries between Rs 25 and 200 a month and of this 45.9 per cent of the workers received incomes between Rs 25 and Rs 75 a month.²⁸ According to the socio-economic survey of 1969-70, about four-fifths of the population earned less than Rs 200 and over half received an income of less than Rs 100 per month. At the end of the 1970s, the per capita income is still in the region of US \$230 and Sri Lanka remained among the poorest thirty-six low income countries in the world.²⁹ Given these circumstances Snodgrass concludes that opportunities for improvement were less favorable in the early 1970s than they had been 25 years before at independence.³⁰ According to Huntington, the reforms of land tenure resulted in a very tangible, immediate socio-economic

²⁵ H.M. Gunasekara, "The Economy of Sri Lanka 1948-73", *The Journal of History and Social Studies*, Vol. 4, 1977, p. 787.

²⁶ D.R. Snodgrass, "Sri Lanka Economic Development During 25 Years of Independence", *The Journal of History and Social Studies*, Vol.4. 1975, pp. 119-125.

²⁷ Central Bank, *Annual Report*, 1970.

²⁸ Central Bank of Ceylon, *Survey of Ceylon's Consumer Finance* 1963, 1964, p. 61.

²⁹ World Bank, *World Development Report*, 1981, p. 134.

³⁰ D.L. Snodgrass, *op.cit.*, pp. 119-125.

satisfaction thereby encouraging political order in agricultural areas.³¹ Therefore, economic development levels become less important and the nature of land tenure grows more relevant to the degree that a country is more or less agricultural. The deteriorating and sometimes stagnant economy deprived the new generations of the means of fulfilling their aspirations in keeping with their educational backgrounds. Although accurate data on unemployment statistics are not available for Sri Lanka, a number of surveys have revealed the magnitude of the problem. From 1959-1960 the official estimated total of unemployed people stood at 340,000 of whom 80 per cent were in rural areas and 20 per cent in urban areas, and were 250,000 males and 90,000 females.³² A socio-economic survey conducted between 1969-70 highlighted that there were some 550,000 unemployed comprising 13 per cent of Sri Lanka's labour force in the age group of 15 and 59 or approximately 43 per cent of the total population.³³ By 1969 there were some 14,000 university graduates and 112,000 young persons with the G.C.E. (O/L) qualifications who had pursued studies in the social sciences and the humanities and were frustrated by the lack of employment opportunities.³⁴

For the educated job seekers finding a job was only one of the problems. The type of the job he would get often caused further frustration. From the colonial period onward there had been a trend towards obtaining white collar employment on the basis of one's family or personal contacts. This system of obtaining employment facilitated the youth belonging to families of influence to secure stable jobs, while the youth in the rural sector who invariably belong to peasant families were at a grave disadvantage. The government in 1970 found it necessary to address itself to this problem and as a result introduced the system of appointing a Political Authority for each district.³⁵ The system further stipulated that a person seeking a job had to obtain a letter of recommendation from the political authority. This represented a form of political patronage and proved to be a barrier hampering those supporting any opposition political party from securing employment. This system also opened the way to corrupt practices such as bribery.

Under-employment was another facet of the economic problem in Sri Lanka. Unlike unemployment, under-employment eludes definitions and assessment. An

³¹ S.P. Huntington, *op.cit.*, pp. 380-383.

³² "A survey of Employment, Unemployment and Underemployment in Ceylon", *International Labour Review*, Vol. 87, 1963, p. 2510.

³³ Central Bank of Ceylon, *Socio-economic Survey of 1969-70.*, 1970.

³⁴ I.L.O. *op.cit.*, p.20.

³⁵ The political authority system was introduced by the United Front government between 1970 to 77. The Political Authority was a Member of Parliament (M.P.) belonging to the ruling party and was accountable to the Prime Minister (P.M.).

underemployed person can be described generally as a person being forced to accept employment below his or her educational level. Definite statistics on under-employment are not available, but are identified on the basis of low earnings. Huntington argues that the higher the level of education of the unemployed, alienated or otherwise dissatisfied person, the more extreme the destabilising behaviour which results.³⁶

Thus, the inadequacy of economic innovation to meet the challenges posed by the country's problems, generated and fostered a sense of frustration mainly among the educated rural youth. The deteriorating and sometimes stagnant economy deprived the new generations of the means of fulfilling their aspirations in keeping with their educational backgrounds. In broad terms social mobilization leads to social frustration when the economy remains static and under-developed. In this light the economic development in Sri Lanka could not meet the aspiration generated by social mobilization. As a result, what emerged was frustration and politicisation among the youth. Given this circumstance, there should be sufficient political development to assimilate the politicized youth. Therefore, from here on this study will examine aspects of political modernization and its nexus with political violence movements (P.V.M) in Sri Lanka.

Political Modernization

For Huntington, political modernization involves the rationalization of authority, the differentiation of structure and the expansion of political participation.³⁷ Four and a half centuries of western colonialism had disrupted traditional political institution in Sri Lanka. The creation of coherent and durable political institutions was among the most vital and difficult of the challenges confronting Sri Lanka as in the case with other developing countries in the world. In contrast to the political systems in Europe which evolved from traditional feudal structures, the political system of Sri Lanka and its modern features were either imposed by colonial powers or by indigenous progressive elites. The first steps towards political modernization in Sri Lanka had been taken within the institutional structures of this system. The post-independent governmental structure was based on the Soulbury Constitution of 1947 which introduced the Westminster model of parliamentary government.

One of the principal effects of modernization is increased participation in politics by social groups throughout society. Sri Lanka also happened to be the first British colony in Asia to receive the universal franchise in 1931. However, it was not until after independence that political awareness and active interest in politics spread widely and rapidly through the rural sector. This political passivity meant that independence certainly did not mark a breakthrough in the political structure, nor did it mark a new beginning facilitating the rise of high aspirations.

After independence, the new government was dominated by a small upper-class elite, whose political vehicle was the United National Party (U.N.P.) established in 1947

³⁶ S.P. Huntington, *op.cit*, p. 49.

³⁷ S.P. Huntington, *op.cit*, p. 48.

on the ruins of the Ceylon National Congress (C.N.C). Its members were, as D.K. Rangnekar remarked, similar to the former colonial rulers in everything but the color of their skins.³⁸ According to Huntington, national leaders who fail to mobilize popular support prior to independence do not rule for long after independence.³⁹ He identifies the political process during the post-independence period as the ruralisation of elections.

Some of the characteristics of these processes as identified by Huntington are many faceted. Accordingly the modernizing elite whose base is derived mainly from the urban middle classes, are driven out of office. Furthermore, the outcome of the election remains unpredictable and cannot be projected by political observers. The political party which gains victory is able to do so because new rural voters were mobilized and the leader of the party undoubtedly was from the modernizing elite but had severed all ties with this elite in favour of a popular charismatic leadership. However, inspite of the leader's elite background other key members of the party are drawn from rural elites. The political issues which proved to be crucial to the rural voters were mainly based on ethnicity and religion and the support derived from the religious leaders in the rural sector were crucial to the victory of the party. Consequently, the victory of the opposition is perceived as a dramatic change in the political process and the party's policies are geared to the rural sector where a majority of its voters are concentrated. These policies however, are found to be unfavorable by the urban based elite who might resort to a military coup d'etat. In many instances the political party which suffered defeat makes an attempt to re-organize and mobilize the new forces of political power and there have been instances where such parties have been re-elected.⁴⁰

The organizing of the Sri Lanka Freedom Party (SLFP) by S.W.R. De Bandaranaike after his resignation from the U.N.P. government in 1951 and the electoral victory of the *Mahajana Eksath Peramuna*, the center-left coalition led by the SLFP, over the ruling U.N.P. in 1956 marked the processes of ruralisation of elections in Sri Lanka. Michal A. Ames sums up the M.E.P. victory of 1956 more explicitly:

"For the first time since colonial rule was imposed on Sri Lanka (Ceylon) over 400 years ago Sinhalese villagers felt able to declare as some did when Bandaranaike's coalition succeeded to office, that it was "*Ape Anduwa*" (our government) as opposed to rule by foreigners and alienated, westernized and Christianized elites."⁴¹

³⁸ D.K. Rangnekar, "The Nationalist Revolution in Ceylon", *Pacific Affairs*, Vol. 33, 1965, p. 363.

³⁹ S.P. Huntington, *op.cit*, p.441.

⁴⁰ S.P. Huntington, *op.cit*, p. 460.

⁴¹ M.A. Ames, "Westernization or Modernization, The Core of the Sinhalese Buddhism", *Social Compass*, Vol. 20, 1973, p. 144.

Consequently, the rural masses had been mobilized into electoral politics. On the other hand, their entry into politics also changed the dominant style, semantics, policies and the leadership within that system.⁴²

With the lowering of the voting age from 21 to 18 years the involvement of youth in the electoral politics expanded. Thus the young people were motivated to participate more actively in electoral politics especially in the election of 1965 and 1970. As Huntington observes, the social and economic changes encouraged by the policy innovation found its way into the political system and required the expansion of the system.⁴³ As a result the potential of the political system in Sri Lanka to accommodate the increased political participation and growing demands through the political development will be examined.

Political development has been viewed in terms of the capacity of the political system to implement collective goals, resolve the issues by which it is confronted and adapt to challenges involved in the emergence of a modern polity. Huntington, defines political development in terms of the institutionalization of political organization and procedures- that is, the processes by which they acquire stability. According to him the level of institutionalization of a political system could be measured by the coherence, complex adaptability and autonomy of its organization and procedures. Coherent means relative absence of disunity. Complexity means permeation of the political system into the society. Adaptability means the ability to meet challenges and survive. Autonomy or legitimacy as perceived by the society. For the nation seeking political order through democratic processes and broad popular participation, the evolution of an institutionalized political party system is of crucial importance. The following statement by Huntington, indicates the importance of political parties in Sri Lanka in terms of their relevance to political stability:

Where new states emerge from colonialism with little or no inheritance of political institutions the stability of the polity depends directly on the strength of the party.⁴⁴

Therefore, political development in Sri Lanka will be examined by focussing upon the political parties in the country with special attention being given to the left-wing parties. However, not all criteria and ramifications of this institutionalization can be examined in detail in the paper. Therefore, a summary analysis is presented.

The introduction of universal franchise in 1931, independence from the British Raj in 1948, and the adaption of a "Westminster-type" parliamentary system of government led to the establishment of political parties which have played decisive roles in Sri Lanka since independence. The growth and the impact of the party system is

⁴² S.P. Huntington, op.cit, p.452.

⁴³ Ibid, p. 145.

⁴⁴ Ibid, p.

evident in the decline of the election of independent candidates in parliamentary elections from 1947 to 1970. In the election of 1947, 21 independent candidates were elected while in 1970 only 2 such candidates were elected.⁴⁵

Within the party system the left-wing movement which started in 1935 with the origin of the Lanka Sama Samaja Party (LSSP) played a significant role in the politics of Sri Lanka. However, developments within the left-wing movement during the decade prior to 1970 played a major role in the creation of the JVP and other such underground organizations.

The lack of coherence within the political parties is clearly indicated from the fragmentation and disunity among the left-wing parties in Sri Lanka. The dissension within the left-wing parties was mainly caused by ideological and policy differences. The first such ideological dispute which occurred in 1939 was on the question of Trotskyism versus Stalinism within the LSSP. As a result, a new party emerged, the United Socialist Party, which in 1943 became the Communist Party (CP) of Sri Lanka. At the end of the Second World War, the LSSP faced yet another crisis when one factions of this party emerged as the Bolshevik Leninist Party (BLP). In 1950, the LSSP and the BLP united to form a single party, but this decision, caused yet another split. The new splinter group came to be known as the *Viplavakari* (Revolutionary) LSSP. This process of dissension and disunity resulting in the emergence of new group and parties was repeated during the period that followed. Of the new groups, the emergence of the pro Maoist Communist Party within the CP is significant in connection of the origin and development of JVP and several other underground organizations. As Calvin Woodward observes much of the disunity might have been prevented if the left-wing movement had developed a centralized organization relatively soon after its formation.⁴⁶ W.A.W Warnapala identifies a strong correlation between the disunity within the left movement and the origin of the JVP.⁴⁷

If the political system is complex and reaches the grassroots level, it will be better able to channel demands to the government and communicate to the people the information the government wants them to receive. However, the left-wing parties did not provide opportunities for younger members to participate in responsible positions. Although, youth were given chores at times of elections after the elections the organizational structure of the major political parties remained inaccessible to the large

⁴⁵ Calvin A. Woodward, "Sri Lanka's Electoral Experience", *Pacific Affairs*, Vol. 47, 1974, p. 456.

⁴⁶ C.A. Woodward, "The Trotskite Movement in Ceylon", *World Politics* Vol. 14, 1961-62, p. 315.

⁴⁷ W.A. Wiswa Warnapala, *The Sri Lankan Political Scene*, New Delhi, Navrang, 1993, pp. 5-8.

number of enthusiastic and dedicated youth.⁴⁸

Moreover, the major political parties were dominated by older politicians from the elite backgrounds, leaving little or no opportunity for the rural youth to have an impact on their policies. The decision-making positions in the political parties as well as in parliament remained in-accessible to the younger groups and this generation gap was reflected in the main spheres of Sri Lankan politics. The average age of Members of Parliament was 35 years or older while only 5 percent of them were below 35 years. In Sri Lanka, politics is the main avenue of upward mobility. Yet few political parties, if any in Sri Lanka are capable of absorbing the large number of politically ambitious individuals who emerged with the broadening of political participation.

The lack of adaptability within the left-parties clearly indicates the generation gap and the wider socio-economic disparities between the orthodox left leadership and the politicized youth in Sri Lanka. The leadership of the left-wing parties were from the wealthy upper stratum of Sri Lankan society who had been educated at foreign universities. Of the Marxist M.P.'s elected in 1970, 7 had been enrolled at overseas universities and another 5 had attended the University of Sri Lanka or the Law College. At least 12 had been educated at leading Colombo schools, such as St. Thomas', Royal and Ananda colleges.⁴⁹ Without an exception they were all over 50 years of age, and were engaged in the elite professions as doctors or lawyers. By 1971, the left-wing movement had been active for 35 years, yet to a great extent its leadership was still confined to the generation of founders. Huntington explains this situation as follows:

"So long as an organization still has its first set of leaders, so long as a procedure is still performed by those who first performed it, its adaptability is still in doubt".⁵⁰

The failure of political parties to retain youth constituencies within the existing political party structure symbolized the lack of autonomy of the political system in general in the country. Huntington observes the effect of a lack of autonomy towards the political system as follows:

"In every society affected by social change new groups arise to participate in politics. Where the political system lack autonomy, these groups gain entry into politics without becoming identified with the established political organizations or acquiescing in the established political procedures".⁵¹

⁴⁸ W.H. Wriggins, *Ceylon: Dilemmas of a New Nation*, Princeton, Princeton University Press, 1960, p. 30.

⁴⁹ James Jupp, *Sri Lanka :Third World Democracy*, London, Frank Cass, 1978, pp.295-296.

⁵⁰ S.P. Huntington, *op.cit*, p. 14.

⁵¹ *Ibid*, p. 21.

The political parties with an elitist orientation not only failed to come to grips with the economic problems encountered by newly emerged rural youth, but also failed to assimilate the youth into the existing political structures. Thus the processes of social mobilization, lack of economic development and lack of political development led to the rise and development of the JVP and similar politically violent movements in Sri Lanka.

Besides, the political violence unleashed by the JVP was precipitated by a combination of two factors. First the propensity and commitment for an armed attack within the organization made it volatile and susceptible to political violence. Second, the failure of successive governments to work out a viable solution to the socio-economic problems and their determination to resort to counter violence triggered political violence.

Conclusion

Political violence has occurred on an unprecedented scale in Sri Lanka since the early 1970s. This violence was pre-planned and organized. The main thrust of this paper is to examine the socio-economic and political factors that have led to the origin and development of politically violent movements in Sri Lanka. For this purpose Huntington's theory of modernization is utilized. To him the expansion of social mobilization coupled with the economic development and the lack of political development provide the conditions for the rise of political violence.

In the case of Sri Lanka the expansion of social mobilization is evident in the rapid growth of population, urbanization, education, literacy, and media. As a result the expectation level rose particularly among the rural youth. The economic conditions which were imperative in meeting these aspirations, however, were lacking because of the stagnations of the economy. Consequently, the new generation of rural youth found their aspirations far short of fulfillment and so were subject to a process of disillusionment and politicization by the mid-1960s. Political modernization was manifest in universal franchise and the ruralization of electoral politics. The measures taken by the MEP or the successive governments, however, failed to fulfil the aspirations of the rural youth and absorb them into the existing political system. The lack of political development is characterized in the nature of political parties particularly in the left-wing parties in Sri Lanka. These are the conditions which proved to be conducive to the formation and fostering of an underground organization which resorted to political violence in Sri Lanka.

Who Benefits from Subsidised Credit? A Tale of Two Agents

C. Ranil Abayasekara

INTRODUCTION

Sri Lanka's rural sector, as in many developing countries, is financed significantly by an informal credit market. Policy-makers have devoted much attention to the apparently high interest rates prevailing in this market. In order to address the problems of rural indebtedness and stagnation, therefore, State-supported credit schemes have involved *subsidised* interest rates.

Some of the recent literature challenges two commonly-held views; that informal interest rates¹ are "high", and that informal lenders operate as (local) *monopolists*. According to Sanderatne [1989a, 1989b]², lenders constitute a varied group such as friends and relatives, professional and semi-professional money-lenders, traders, and landlords. The nature of the credit "contract" is seen to vary according to the type of lender (and borrower). *Interest-free* loans often constitute the bulk of credit volume.

Do zero-interest credit transactions carry hidden costs? Where the parties consist of friends or relatives, the literature does not ascribe a *profit* motive to the lender. However it is acknowledged that in the case of *inter-linked* market transactions, the return to lending can accrue in a market other than that for credit. For example, Sanderatne [1989a] sees landlords varying the terms of tenancy contracts to yield a gain from providing cultivation credit to tenants³. In such cases, the true interest rate would be positive⁴.

Inter-linked transactions are usually based on long-standing relationships, which may act as a barrier to the entry of new sellers. Such a barrier would then confer a degree of monopoly power on the existing seller, or lender. One possible result would be high interest rates. There are, of course, other plausible explanations for the latter. Examples are, high opportunity costs of loan funds, default risk and low elasticity of demand for credit.

The existence of monopoly power is of more than academic interest for the following reason. It can give rise to *strategic* behaviour by informal lenders in response to changes in the market. This, in turn, may reduce the likelihood of government policy measures achieving their goals. Official pronouncements by policy makers show no recognition of this possibility.

¹ Discussion is usually in terms of *nominal* rather than *real* rates. Informal rates are compared with unsubsidised rates charged by commercial banks.

² Also see Fernando [1987].

³ Another instance is when sellers of consumption goods on credit "over-price" their products.

⁴ At least, in nominal terms.

As an example, consider a farmer who purchases inputs on credit from a particular shop-keeper. Suppose a bank offers a cultivation loan on "soft" terms. What happens if it finances only part of the farmer's working capital? He will still be dependent on the shop-keeper's credit for the balance. However, provided there is no change in prices, the farmer's net income - after loan repayment - will be higher. But the shop-keeper may seek to capture some of this increased income by raising the prices of his inputs. The bank then benefits the shop-keeper, and perhaps not the farmer at all.

The relevance of this example for the Sri Lankan rural sector may be questioned. It is well-known that banks typically finance only part of production costs⁵. For the sake of argument, however, suppose all such costs were covered; the above story holds as long as bank clients are dependent on informal credit sources for *consumption* and *sudden contingency* needs. It becomes even more plausible due to the inelastic nature of credit demand for the latter types of requirements.

Another issue emerges when more than one credit source is involved: Which lender will receive priority in loan repayment? A stylised fact in Sri Lanka is that *informal* lenders are repaid first (see Sanderatne [1989a]). Then higher *informal debt* will increase the default probability on *formal* sector loans⁶. However, for one class of borrowers, this probability does not change. They are those *intending to default all along*. (Their default probability is equal to one). They may be classified as *intentional defaulters* or *dishonest borrowers*⁷. Since their *retained* incomes are higher (than those of honest borrowers), they should make attractive clients for informal lenders!

The objective of this paper is to provide a formal example of the above type of borrower-lender interaction. Two agents are involved, as follows. There is an informal

⁵ Harriss [1977] provides an interesting story from Hambantota. Whenever a (State) bank raised the credit ceiling for hiring of tractors, charges for the latter also went up. The reason was that sellers of this service were also offering credit; hence, acting oligopolistically, they made sure that they were not pushed out of the credit market.

⁶ There are two effects. First, repayment of informal debt lowers borrower incomes, inducing some to default on the formal sector. Second, in anticipation of this problem, some borrowers may decline the formal sector loan; they would forego credit rather than be "forced" into defaulting. Then the proportion of borrowers *willing to default* increases (an "adverse selection" effect). For a fuller treatment, see Abayasekara [1990].

⁷ The term *wilful* defaulter is often used to describe a borrower who refuses to repay despite a "satisfactory" income level. Piyatissa [1981] refers to a Central Bank survey of defaults in 1972, in which almost 20% of defaulters *stated openly* that they had no intention of repaying. The terminology used in this paper is more satisfactory because it clearly indicates the borrower's intention *at the time of loan receipt*.

lender⁸ (hereafter, "lender") who is a *monopolist*, and a producer, who is a *dishonest borrower* (with regard to the formal sector). There is also a formal sector financial institution ("bank"), which, however, only plays a passive role. It channels a government credit package to interested borrowers. Note that there is no claim that the informal rural credit market is (largely) monopolistic. The idea is to show an inconsistency between a categorisation of the market and the expected policy outcome.

The paper is organised as follows. Section I introduces a model of informal credit. Section II depicts the lender's response to the availability of bank credit. Section III imposes a constraint on the (informal) lender's optimising strategy, and section IV offers some conclusions.

SECTION I: A MODEL OF INFORMAL CREDIT

Consider production within a one-period frame-work. Investment is perfectly indivisible and takes place at the beginning of the period. Let it be equal to unity without loss of generality. The lender is endowed with one unit⁹ whereas the producer has no investible funds of his own; he borrows the entire unit from the former. Output, x , which is observed at the end of the period, is a random variable such that $0 \leq x \leq w$. Let the probability density function of x be $f(x)$, and its cumulative distribution, $F(x)$. $f(x)$ and $F(x)$ are assumed known to both borrower and lender.

If r_1 is the interest rate, the end-of-period debt is equal to $R_1 = (1+r_1)$. The borrower does not possess acceptable collateral, and so the lender provides the following *default clause*; whenever $x < R_1$, the borrower is in default, and the lender appropriates x ¹⁰. When $x \geq R_1$, complete loan repayment takes place, leaving the borrower with a surplus equal to $(x-R_1)$.

The producer has alternative employment yielding the (certain) return, A . Thus A functions as his reservation income. The lender's (certain) opportunity cost of funds is i (per unit). By assuming both parties to be risk-neutral, their utilities can be defined in terms of profit or income.

The lender's expected gross return from lending to the producer is given by

⁸ It is assumed here that only credit is involved. Braverman and Srinivasan [1981] model a landlord-tenant relationship. They achieve similar results (but without uncertainty).

⁹ The results are the same if the lender's resources are greater than one. If they are *less*, then the borrower needs to access another credit source.

¹⁰ Hence the borrower obtains a zero surplus. It must then be assumed that he has other means of meeting basic consumption needs.

$$\int_0^{R_1} xf(x) dx + \int_{R_1}^w R_1 f(x) dx$$

or

$$\left\{ \int_0^{R_1} xf(x) dx + R_1 [1 - F(R_1)] \right\}.$$

His gross return from the alternative investment is equal to $(1+i)$. The producer's utility (expected income), U_1 , is equal to¹¹

$$\int_{R_1}^w (x - R_1) f(x) dx$$

which can be expressed as

$$\left\{ E(x) - \int_0^{R_1} xf(x) dx - R_1 [1 - F(R_1)] \right\}.$$

If EP_1 denotes the lender's expected net profit (from lending to the producer), the latter's strategy is as follows.

¹¹ Recall that when $x < R_1$, the borrower forfeits his entire output to the lender.

$$\text{Max}_{R_1} EP_1 = \int_0^{R_1} xf(x) dx + R_1 [1 - F(R_1)] - (1+i) \quad (1)$$

subject to¹²

$$U_1 = E(x) - \int_0^{R_1} xf(x) dx - R_1 [1 - F(R_1)] \geq A \quad (2)$$

EP_1 is monotonic increasing and U_1 is monotonic decreasing in R_1 . In fact, $d(EP_1)/dR_1 = [1 - F(R_1)] = -dU_1/dR_1$ ¹³; i.e., choosing R_1 constitutes a *zero-sum game* between lender and borrower. The profit-maximising value, R_1^* is determined by pushing the borrower down to his reservation income, A , so that

$$U_1(R_1^*) = E(x) - \int_0^{R_1^*} xf(x) dx - R_1^* [1 - F(R_1^*)] = A \quad (3)$$

Hence $R_1^* = R_1^*(A)$, the functional relationship being negative; the higher (lower) the value of A , the lower (higher) the value of R_1^* ¹⁴. The credit transaction takes place only if $EP_1(R_1^*) \geq 0$.

SECTION II: LENDING BY BOTH BANK AND INFORMAL LENDER

Suppose the bank offers a loan amount, $(1-s)$ (with $s < 1$) at a fixed interest rate, r_b . If $R_b = (1+r_b)$, accepting the bank loan results nominally in a debt of $(1-s)R_b$. However, since the borrower is *dishonest*, the bank loan does not really entail any obligation; it is in effect a *grant*.

The producer now demands a loan equal to s from the lender. Let r_2 be the interest

¹² Also note the constraint that (1) should be non-negative in equilibrium.

¹³ See equations (A3) and (A4) in the Mathematical Appendix.

¹⁴ For a formal proof, see (A5) and below in the Mathematical Appendix.

rate on such a loan¹⁵. Then, if $R_2 = (1+r_2)$, the producer's debt to the lender is sR_2 . The latter's gross earnings from lending is equal to¹⁶

$$\left\{ \int_0^{sR_2} xf(x) dx + sR_2 [1 - F(sR_2)] \right\}$$

He also earns an amount equal to $(1-s)(1+i)$ from investing his balance endowment elsewhere. If EP_2 is the lender's expected net profit, his strategy is given by

$$\text{Max}_{R_2} EP_2 = (1-s)(1+i) + \int_0^{sR_2} x(fx) dx + sR_2 [1 - F(sR_2)] - (1+i) \quad (4)$$

subject to¹⁷

$$U_2 = E(x) - \int_0^{sR_2} xf(x) dx - sR_2 [1 - F(sR_2)] \geq A \quad (5)$$

As before, this is a zero-sum game. If there is no upper bound on the value of R_2 (other than that of (5)), the profit-maximising level is R_2^* , defined by

¹⁵ In principle, the lender can make a counter offer, setting both the (new) loan size and interest rate. However, he cannot supply *less than* s , given the investment indivisibility assumption. Also, for reasons of profitability - as shown below - he will not offer *more than* s , even if the bank was willing to accommodate him. Hence I shall model the interest rate as his sole decision variable for the present.

¹⁶ This is clearly seen by substituting sR_2 for R_1 in (1). Similarly, the borrower's utility is derived by doing the same substitution in (2).

¹⁷ The formulation of (5) assumes that there is no penalty of default (on the bank). If it is explicitly included in the model, the producer's return with and without default can be compared. A high penalty (therefore inducing repayment) implies an *honest* borrower, and a low penalty, a *dishonest* one. Since only the latter type is considered in this paper, the simplest possibility, viz., a zero penalty has been assumed.

$$U_2(R_2^*) = E(x) - \int_0^{sR_2^*} xf(x) dx - sR_2^* [1 - F(sR_2^*)] = A \quad (6)$$

(6) shows that the borrower remains at his reservation utility (income) level *even after borrowing from the bank*. The benefit of the bank "grant" must then have accrued entirely to the informal lender. This is easily seen by comparing the latter's expected profit maxima in the two situations. Let $EP_1(R_1^*)$ and $EP_2(R_2^*)$ be denoted by EP_1^* and EP_2^* , respectively.

From (1) and (3),

$$EP_1^* = E(x) - A - (1+i) \quad (7)$$

From (4) and (6),

$$EP_2^* = (1-s)(1+i) + E(x) - A - (1+i) \quad (8)$$

Subtracting (7) from (8) yields

$$EP_2^* - EP_1^* = (1-s)(1+i) > 0 \quad (9)$$

provided $s < 1$.

When the lender's share, s is exactly one, the lender is back in the first situation, viz., monopoly of total credit. Note however, the important result revealed in (9); *the smaller the value of s , the greater the increase in the lender's expected profit*. This means that the lender *prefers to lend a smaller share of the total credit requirement*¹⁸! The reasoning is straightforward, as follows. Whatever his share of total credit, the lender is able to extract the producer's surplus (above A). By lending smaller amounts, however, he has additional funds left for investment elsewhere. Thus he earns *an* additional income (net) at the rate of i per unit. This is seen by comparing (7) and (8); the smaller his exposure to the producer's project, the higher the *extra* income.

The above result is generated by the lender's relative freedom to raise the interest rate. If this is a landlord-tenant (credit) transaction, the former must be able to raise his share of output. A boutique-keeper lender must be able to charge higher prices for the producer's inputs, or pay lower prices for the latter's output.

In actual fact, some restriction may exist on the lender's ability to change the terms of the contract¹⁹. This may be socially determined. For example, if the customary share of the landlord is one-third (of the harvest), it is unlikely that it could be raised to, say, nine-tenths. Even with an informal monopoly lender, then, subsidised bank credit may benefit a producer *given an exogenous restriction of the above type*. In section III, I consider this possibility.

SECTION III: RESTRICTION ON INFORMAL INTEREST RATE

Suppose the lender's interest rate is subject to a ceiling of r_m (with $R_m = (1+r_m)$).

¹⁸ Provided, of course, that it is positive. If $s = 0$, the lender forfeits the producer's surplus.

¹⁹ I.e., a restriction other than that of (2) or (5).

The lender's expected profit from lending s at r_m , is

$$EP_3 = (1 - s)(1 + i) + \int_0^{sR_m} xf(x) dx + sR_m[1 - F(sR_m)] - (1 + i) \quad (10)$$

Such a contract may or may not be acceptable to the lender. If r_m is binding, lender preferences may now be incorporated by *treating s as his decision variable*. His offer of $s - s^*$ will vary between *one* and *zero*. Differentiating (10) with respect to s ,

$$\frac{d(EP_3)}{ds} = -(1 + i) + R_m[1 - F(sR_m)] \quad (11)$$

The second derivative is

$$\frac{d^2(EP_3)}{ds^2} = -R_m^2 f(sR_m) < 0 \quad (12)$$

Provided it exists, an interior solution for s , $s^*(r_m, i)$ is yielded by equating (11) with zero.

More to the point, what happens if s^* does not equal the demanded value of s ? Denoting the latter by \underline{s} , s^* may be greater or smaller than \underline{s} ²⁰. The latter is not feasible (for the borrower). Suppose $s^* > \underline{s}$. Then the producer's total borrowing would exceed the required unit. Due to the higher (unproductive) debt, he would also be giving up a portion of his income to the lender. If he refuses the offer, the lender, in turn, may threaten to withhold credit completely. The outcome will depend on the *credibility* of such threats²¹, and the bargaining power of the parties.

In the following simple analysis, I consider two sets of factors: 1) The effective range for r_m , and 2) the existence or otherwise of an interior solution for s^* .

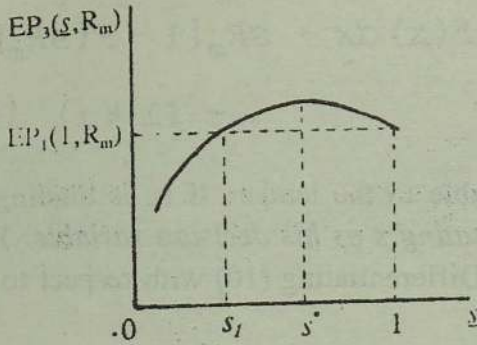
(a) $R_m < R_1^* (< R_2^*)$

Here the lender's profit maximisation even under pure monopoly is restricted. Hence the producer is not driven down to his reservation income level. When the bank comes in, the lender compares his expected profit, $EP_3(s, R_m)$, with his pure monopoly profit, $EP_1(1, R_m)$.

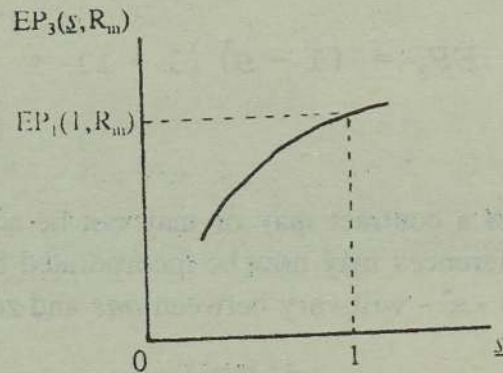
Consider the figures below. In 1a, the profit-maximising value of s is $s^* (< 1)$. 1b represents a corner solution, with EP_3 maximised at $s = 1$.

²⁰ See section II in the mathematical appendix.

²¹ For instance, suppose the lender can still earn a positive net profit at \underline{s} . His threat has less credibility, and the borrower may call his "bluff".



[Figure 1a]



[Figure 1b]

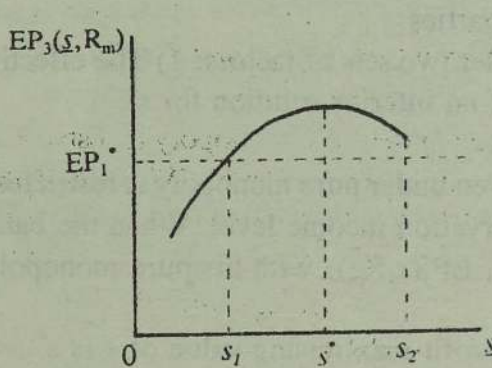
In figure 1a, suppose $s_1 \leq s \leq 1$. The lender - while aiming for s^* - is prepared to bargain over the whole range. Hence s is a feasible outcome. If $s < s_1$, however, he will exert pressure on the producer to borrow the whole unit from him. Thus the producer will potentially benefit from subsidised credit only if $s_1 \leq s \leq 1$ ²².

In 1b, there is no value of $s (< 1)$ for the lender that dominates the pure monopoly situation.

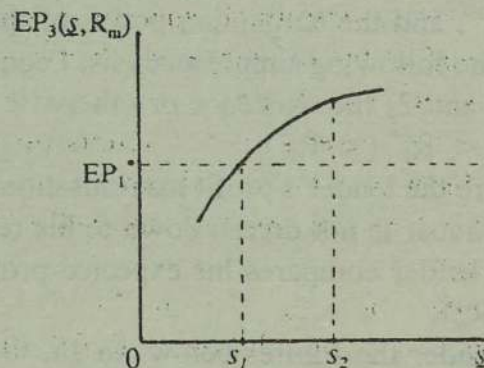
(b) $R_1^* < R_m < R_2^*$

The lender is able to set R_1^* as a pure monopolist. In providing s , however, he cannot set the previous optimal rate, R_2^* . Let s_2 denote the loan amount at which R_m becomes binding²³.

Then the lender's choices can be depicted as follows.



[Figure 2a]



[Figure 2b]

²² The presence of two lenders creates opposing forces on borrower utility. See the discussion in Section III of the Mathematical Appendix.

²³ I.e. when s falls below s_2 , the lender can no longer charge R_2^* .

In both 2a and 2b, suppose s is such that $s_1 \leq s \leq s_2$. Then, since the lender can do no worse than his monopoly position (EP_1), s is a feasible outcome. If his share is below s_1 , however, he will prefer to lend the entire unit.

SECTION IV: CONCLUSIONS

Rural informal lenders in Sri Lanka are often thought to possess monopoly power. This is unlikely to be true of the entire sector, although particular instances may exist, e.g., with inter-linked transactions. Given such power, however, informal lenders may engage in strategic responses to government-sponsored credit programs. In this paper, I have attempted to model such a response.

Formal credit supply alone usually fulfills only part of credit demand. Thus borrowers remain dependent on informal lenders. Suppose, by setting loan terms, an informal lender can keep a borrower at the latter's reservation utility level. Any benefits to the borrower from formal credit are then appropriated by the informal lender.

The specific results of the model depend on the strong assumption of investment indivisibility. However, where credit demand for a variety of needs is inelastic (with respect to the interest rate), similar results can be anticipated.

Informal lending does not take place in a social vacuum. There may be various constraints - "moral" or otherwise - on the lender's ability to change his loan terms. In such situations, formal credit *may* benefit borrowers. This is true when the informal lender himself finds it relatively profitable to lend the amount demanded. If his share of credit is too small, however, he can make counter-offers to borrowers. One such instance is when he threatens to withhold credit unless he is allowed to retain his monopoly. The actual outcome depends on the credibility of threats and the parties' bargaining powers, etc. Borrowers may or may not end up with higher utility (or income).

Special assumptions limit the applicability of the model. For instance, borrowers and lenders may be risk-averse, rather than risk-neutral. Again, actual contracts may not contain the default clause modelled here. The purpose of the model, however, is to show that policy prescriptions must match the diagnosis.

MATHEMATICAL APPENDIX

Section I: Pure Monopoly

$$EP_1 = \int_0^{R_1} xf(x) dx + R_1 [1 - F(R_1)] - (1 + i) \quad (A1)$$

$$U_1 = E(x) - \int_0^{R_1} xf(x) dx - R_1 [1 - F(R_1)] \quad (A2)$$

Differentiating with respect to R_1 ,

$$\begin{aligned} d(EP_1)/dR_1 &= R_1 f(R_1) - R_1 f(R_1) + [1 - F(R_1)] \\ &= [1 - F(R_1)] > 0, \text{ provided } R_1 < w \end{aligned} \quad (A3)$$

$$\begin{aligned} dU_1/dR_1 &= -R_1 f(R_1) + R_1 f(R_1) - [1 - F(R_1)] \\ &= -[1 - F(R_1)] < 0 \end{aligned} \quad (A4)$$

$$U_1(R_1^*) = E(x) - \int_0^{R_1^*} x f(x) dx - R_1^* [1 - F(R_1^*)] = A \quad (A5)$$

Totally differentiating (A5),

$$-[1 - F(R_1^*)]dR_1^* = dA, \text{ so that}$$

$$\frac{dR_1^*}{dA} = \frac{(-1)}{[1 - F(R_1^*)]} < 0 \quad (A6)$$

Section II: Lender Preferences for s , given r_m

From (11),

$$\frac{d(EP_3)}{ds} \begin{matrix} > \\ < \end{matrix} = 0 \quad \text{iff.} \quad R_m [1 - F(sR_m)] \begin{matrix} > \\ < \end{matrix} (1 + i) \quad (A7)$$

Consider the left hand side of the second expression in (13); it is the expected gross return from lending, at the margin, *in states of no default*. If this is higher (lower) than the alternative return, the lender desires a larger (smaller) loan fraction.

Section III: Producer Utility Levels at R_m

Pure informal sector monopoly yields

$$U_a(R_m) = E(x) - \int_0^{R_m} x f(x) dx - R_m [1 - F(R_m)] \quad (A8)$$

Borrowing s from informal lender yields

$$U_b(s, R_m) = E(x) - \int_0^{sR_m} x f(x) dx - sR_m [1 - F(sR_m)] \quad (A9)$$

Subtracting (A8) from (A9) yields

$$U_b - U_a = \int_{sR_m}^{R_m} x f(x) dx + R_m [1 - F(R_m)] - sR_m [1 - F(sR_m)] \quad (A10)$$

The meanings of the terms in (A10) are as follows. The first term denotes the gain to the

borrower because of a drop in default probability. Since he owes less to the lender, his expected payment on account of default is also less.

The second and third terms both represent expected payments in states where default does not occur. The difference in their values cannot be signed unambiguously. Consider the drop in default probability from borrowing s instead of 1. The producer has a greater expectation that he will have to repay the whole loan; this is an "adverse" effect. However, he pays only sR_m instead of R_m ; i.e., the total debt is also less.

A *sufficient* condition for $(U_b - U_a) > 0$ is given by

$$R_m[1 - F(R_m)] - sR_m[1 - F(sR_m)] > 0, \text{ or}$$

$$s < \frac{1 - F(R_m)}{1 - F(sR_m)}$$

I.e., when s is less than the ratio of the respective probabilities of *not defaulting* on the informal lender.

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External Intervention in Ethnic Conflict: An Examination of the Role of Interest Factor with Special Reference to the Indian Involvement in the Ethnic Conflict in Sri Lanka¹

S.K. Pinnawala

Transnational Dimension of Ethnic Conflict.

Until recently ethnic conflict was considered by scholars as part of domestic politics and received only passing attention in discussions of international relations. The majority of the available literature on the subject therefore is confined to analysis of issues related to either national or sub-national aspects of ethnic conflict.² This situation began to change only in the late 1970s, but since then students of international relations slowly have been turning to ethnic variables to explain trans-state relationships and transnational relationships³. Broadly speaking there are two reasons for this new development. The first is the realization by students of international relations of the importance of non-state actors in the explanation of global political developments (Keohane and Nye, 1972; 1977; Suhrke and Noble, 1984; Sheffer, 1986). This shifted the attention of scholars to international relations founded on relationships other than formal state to state relations. The linkages based on ethnic loyalties, namely irredentist and diaspora connections and to some extent ethnic economic networks (Esman, 1990), thus became part of the study of international relations. The second reason for this development is the increasing number of incidents of ethnic conflicts all over the world. The events in the past two decades show that not only domestic ethnic conflicts have increased both by volume and in intensity but also they have begun extending beyond national boundaries, mainly through irredentist and diaspora links that are conveniently exploited and manipulated by various interested parties. The result of this was ethnic conflicts becoming a major aspect of world conflicts.

¹ This is a revised version of a paper presented at the Fifth Annual Meeting of the Peace Studies Association at the Pennsylvania State University on March 11, 1993

² Sociology and comparative politics clearly lead the field in terms of the number of studies on ethnicity and ethnic mobilization. Yet studies by sociologists and political scientists do not examine the influence of the ethnic variable in extra-national contexts. On the other hand scholars who attempted to study linkages between domestic and foreign policies either did not consider ethnic variable as important (see for example Rosenau 1969) or played down the importance of the ethnic factor (Kende, 1971).

³ Trans-state relationship is the term used by Sheffer (1986). The term transnational relationships on the other hand is used by others such as Keohane (Keohane and Nye, 1972).

With the increasing importance of ethnic conflict in the contemporary world the role of transnational ethnic linkages, therefore, has assumed a new position in inter state relations. Ethnic concerns have begun to play an increasingly important role in foreign policy decisions and diplomatic activities among states. Examples are many. The conflict in Cyprus involved both Greece and Turkey and finally resulted in Turkey invading the island to rescue its co-ethnics. The conflict in Sri Lanka is another example of transnational ethnic links playing a critical role in the intervention of an external power in an ethnic conflict. Though transnational ethnic links are not the only reason for external intervention in ethnic conflicts, (for a discussion on external intervention in different situations see Cooper and Berdal 1993) the mobilization of such links by interested external actors is an integral part of ethnic politics today. Though this may seem to be stating the obvious, it has added a transnational dimension to ethnic conflict. The result of this development is that understanding the transnational dimension of ethnic conflict has become necessary to understand not only the different expressions of ethnicity but also the dynamics of interstate relationships.

The transnational dimension of ethnic conflict is characterized by three parties who are brought into contact on the basis of ethnicity. These are the home country, the host country and the ethnic community, which is either a diaspora or an irredenta, that makes up the linkage. There are no disagreements among scholars that this triadic relationship is central to the explanation of ethnic conflict in the international context. The important issue in this context is the relevance of ethnic loyalties to understanding the interaction among these parties and how ethnicity influences inter-state relationships. In other words the question that needs explaining relates to the factors that make the ethnic link salient in a given situation, which in turn brings intervention and conflict into inter-state relationships. There is no need to reiterate the fact that the saliency of the ethnic factors in any given situation is a result of some form of interest mobilization. This is true of transnational ethnic links as well.

This paper is both descriptive and explanatory. It examines the Indian intervention in the ethnic conflict in Sri Lanka in order to understand the factors that led to Indian involvement in the conflict. I argue that to understand the mobilization of transnational ethnic links, which makes ethnicity salient in interstate interaction, one has to understand the interactive relationship among various interests on the basis of ethnicity. Two sets of interests are identified, namely, interests of the intervening government and interests of the groups, that are either part of or benefit from such conflict situation. To explain the interaction between the above two sets of interests the paper examines the different forms of involvement by certain interest groups, both Indian and Sri Lankan, and the congruence of their interests with the interests of the state actors involved. The importance of the ethnic conflict in Sri Lanka to the intervening power, namely India's security concerns and domestic politics, the mobilization of ethnic loyalties by interest groups involved, either directly or indirectly, in the conflict and how they shaped the Indian intervention in Sri Lankan ethnic conflict will be examined in this paper.

An overview of the Ethnic Conflict in Sri Lanka

The two major players in Sri Lanka's ethnic conflict are the Sinhalese and the Tamil communities of the country. The Sinhalese who are the majority of the country are roughly about 75% of the population⁴. More than 90% of the Sinhalese are Buddhists and the rest are Christians. The Tamil population in the country on the other hand is divided into two broad groups, each with its own historical origin and culture. They are however united on the basis of language. The first of the two Tamil groups is the Sri Lankan Tamils. They consist of about 12% of the country's population. The Sri Lankan Tamils are concentrated in the Northern province and to lesser extent in the Eastern province of the country. The majority of Sri Lankan Tamils are Hindus (about 90%) while the rest are Christian. The second Tamil group, which is of recent Indian origin, is the Plantation Tamils, who are also referred to as the Indian Tamils. The plantation Tamils were brought to Sri Lanka by the British to work in the tea plantations in the hill country. They are about 6% of the country's population and live mostly in tea estates in the Central Highlands of the country. Though the majority of the Plantation Tamils are Hindus, there is a substantial proportion of Christians among them. Both Tamils and Sinhalese are primarily ethno-linguistic categories but their respective traditional religions, i.e., Hinduism and Buddhism, also play a significant role, specially among the Sinhalese (Obeyesekere 1978, 155p), in their ethnic identity.

As mentioned, the polyethnic character of Sri Lankan society has a very long history. Prior to the arrival of the Portuguese, the first western colonial power to have contacts with the island and establish its rule in the coastal areas, Sri Lanka was inhabited by three ethnic groups, namely the Sinhalese and the Tamils and the Moors. There had been different kingdoms in the different parts of the country during different periods but the population of these kingdoms were not divided along ethnic lines. At the time Portuguese arrived in the country, however, there was a Tamil Hindu Kingdom in the Northern part of the country. As no king was content to see himself as ruler of only part of the island, there naturally were conflicts in the past to determine the ruler of the whole island. Those wars, however, cannot be considered ethnic conflict, as they were between different kingdoms inhabited by both Tamils and Sinhalese.

The British captured the whole island in 1815 and brought it under their rule in a single administrative unit. Although there was resentment and mutual distrust between Tamils and Sinhalese, the two groups acted in co-operation during the British period against the British, who were the common enemy. It was the independence in 1947 that brought the conflict between the two groups into the open. The first post independence political confrontation between the two communities occurred when the first parliament of the country dominated by Sinhalese decided to pass a law depriving the Plantation

⁴ The ethnic distribution of Sri Lanka's population is, Sinhalese 74%, Sri Lankan Tamils 12.6%, Indian Tamils 5.6%, Moors 7.1% and Others 0.7%. The religious distribution is Buddhists 69.3%, Hindus 15.5%, Muslims 7.6%, Christians 7.5% and Others 0.1%.

Source:- Statistical Abstracts of the Democratic Socialist Republic of Sri Lanka 1982 (Colombo: Dept. of Census and Statistics, 1983:pp 32-34)

Tamils of Sri Lankan citizenship. With that a group of Tamil parliamentarians formed the Federal Party⁵, declaring that "unless there is a federal system established there would not be a just settlement to the problems faced by the Tamil minority in Sri Lanka." The Federal Party at the time did not openly advocate separatism from the Sri Lankan society. They wanted only a federal system for Sri Lanka so that the Tamils could manage their own affairs within the Sri Lankan polity.

The struggle by the Tamils for a separate sovereign state is therefore of recent origin. It began in the seventies with the declared aim of liberating the homeland of the "Tamil Speaking Peoples" in the country. The term "Tamil speaking peoples" used by Tamil politicians with regard to the demand for a separate state for the Tamils is not without confusion and has been subjected to definitions and redefinitions over time, particularly during the struggle. Tamil political leaders first used the term in the late 19th century and according to that definition, in addition to Tamils, the Tamil speaking people in Sri Lanka included Muslims, mainly those in the Northern and Eastern provinces (Ramanathan 1888). The Muslims have, however, always resented attempts by Tamil political leaders to consider them as part of the Tamil community. The Tamil separatist movement on the other hand initially adhered to this definition by early Tamil politicians of Tamils in terms of language. Today, however, the term has lost its value and the leading Tamil guerilla group in the country openly rejects the inclusion of Muslims as part of the Tamil community. This group for example launched a systematic program of ethnic cleansing⁶ in 1990 to get the Muslims out of the Northern and Eastern provinces. Further, the Tamil separatist struggle does not get any significant support from the country's plantation Tamils even though the political leader of the Plantation Tamils was one of the signatories to the declaration establishing the Tamil United Front in 1976, which was the predecessor to the separatist Tamil United Liberation Front (TULF), and also there have been attempts by Tamil militants to attract the support of up country Tamil youth. In fact, before the separatist struggle came into existence the Sri Lankan Tamils rejected even the notion that they and the plantation Tamils belong

⁵ Though the party is popularly known as the Federal Party the Tamil name of it is "Illangai Tamil Arasu Katchi" which translated into English means "Sri Lanka Tamil State Party". The name gave the Tamil population the belief that it was formed to fight a separate Tamil state not a federal system.

⁶ During the early stages of the Tamil separatist struggle ethnic cleansing was aimed at getting the Sinhalese out of "Traditional Tamil Homeland" by attacking Sinhalese villages in the North and the East. Initially several Tamil militant groups had members belonging to the Muslim community in the North and East. In 1990 the Liberation Tigers of Tamil Eelam declared that Muslims were traitors and started a violent movement to chase them out of the so called "Traditional Tamil Homeland". Today, the Muslims who once were inhabitants of the areas of the "Tamil Homeland" that are under the control of the militants live in refugee camps.

to the same group⁷. The Tamil separatist movement in the country, therefore, is a movement by the Sri Lankan Tamils for the Sri Lankan Tamils. Further the separatist movement is dominated by Jaffna Tamils who consider themselves as the superior group of the Tamils in the country.

Though the formation of the Federal Party marked a new era of Tamil politics there were no significant political events in terms of ethnic politics during the life of the first two post-independence parliaments. The first major confrontation between the two communities occurred in 1956 when the government of the country changed hands, and the incoming regime introduced a bill proclaiming the Sinhala language to be the official language of the country. Tamils saw this as a gross injustice against their community and started a series of non-violent protest rallies which were attacked by Sinhalese mobs. The economic hardship and rising unemployment which Sri Lanka began experiencing in the early 1970s further complicated the Sinhala-Tamil relationship. When the economy began contracting the Tamils were the first to suffer. The situation was further aggravated by the introduction of standardization of university admissions in 1972 which restricted the intake of Tamil students to universities (de Silva 1974). Also in the same year Sri Lanka promulgated a new constitution that removed the constitutional guarantees given to the minorities in the country. Not only was the government indifferent to the protests by the Tamils, but also those who organized protest rallies against these decisions, in areas where Sinhalese were the majority, were attacked by Sinhalese mobs. With these developments one can observe emergence of sporadic student/youth agitations in the North of the country protesting the conduct of the Sri Lanka government and also pressurizing the Tamil political leaders to adopt a hard line attitude towards the increasing Sinhalization of the country. The result of that was the decision by the Federal Party leadership in May 1973 to work for an "Independent Tamil State". This decision marks the formal beginning of the ethnic separatist struggle by the Tamils of Sri Lanka.

The intention of the Tamil minority of the country to separate from the Sri Lankan state was officially announced in October 1976 by a hurriedly established coalition of three Tamil based political parties. The parties involved in the coalition were the Federal Party (FP) which was the main political party of the Tamils at the time, The Tamil Congress (TC) and the Ceylon Workers Congress (CWC) (Kodikara 1981:p.194). Of the three parties the first two had their support base in the North and East of the country while the Ceylon Workers Congress represented the Tamils of the hill country, i.e., the plantation Tamils. The three parties formed a new political coalition called the Tamil United Liberation Front (TULF), which was to be the umbrella organization to agitate for a separate state in the North and East of Sri Lanka. Though there may have been rhetorical statements on occasion by a few of the participants of achieving their aim even through violent means, the declared strategy of the coalition was a non-violent one.

In the early 1980s the agitation by the Tamil minority for a separate state began moving slowly towards militarization of its strategy. During this period militant political

⁷ For example one Sri Lankan Tamil scholar Dr. S. Arasaratnam does not even discuss the Plantation Tamil group in his book on the peoples of Sri Lanka (Arasaratnam, 1964).

groups advocating armed struggle to achieve a separate state began emerging among the Tamils (O'Ballance 1989, Kadian 1990). The Tamil separatist struggle is carried out today primarily by a highly organized guerilla group called the Liberation Tigers of Tamil Eelam (LTTE), popularly known as the "Tigers", in the field and by several other groups including- in the parliament- the Federal Party. The Tamil military struggle has a high level of international exposure. Though the leaders of both groups claim that their strength is the Tamils of Sri Lanka, there is no doubt that the Tamil separatism depends heavily on support from outside the country for its existence. In other words the Tamil ethnic separatism is not just an ethnic struggle taking place within national boundaries. It has a clearly visible transnational component which is essential for its existence. The ethnic linkages with India by the Tamil community is one part of this transnational connection.

Though the Federal Party was the first Tamil political organization to declare the intention to fight for a Tamil Homeland called "Eelam", it never was in the center of the struggle for a separate independent state. With the Tamil stand against the government hardening there emerged several militant organizations that later displaced the Federal Party from Tamil politics in Sri Lanka. The first militant group to emerge among the Tamils was the Tamil New Tigers (TNT) which was formed in 1972. In 1976 the Tamil New Tigers changed its name to Liberation Tigers of Tamil Eelam (LTTE) (O'Ballance, 1989, p.13). The Liberation Tigers of Tamil Eelam (LTTE) is the most powerful Tamil group today. During the same period some other groups also emerged, namely the Tamil Eelam Liberation Organization (TELO) in 1973, Eelam Revolutionary Organization of Students (EROS) in 1975 (O'Ballance, 1989:p.12), People's Liberation Organization of Tamil Eelam (PLOTE) in 1980 and Eelam People's Revolutionary Liberation Front (EPRLF) in 1981 (Kadian, 1990,pp 23-24). Of these, EROS and TELO were set up in foreign countries, in England and India respectively (Kadian, 1990:p.65). The ethnic riots in 1978 and the unprecedented violence in 1983 July against the Tamils followed agitations by the main stream Tamil parties and sporadic military attacks against government forces and institutions by the militants. The 1983 violence which is referred to as the "Black July" formally marked the ongoing ethnic civil war in Sri Lanka.

Tamil Minority in Sri Lanka and Indo-Lanka Transnational Relations

The transnational ethnic linkages between Sri Lanka and India are based on the links that binds the two Tamil groups in Sri Lanka with their brethren in South India. Of these two the Sri Lankan Tamils were not very much concerned about their ethnic links with India until the ethnic struggle became the main issue for the Tamils in Sri Lanka. In fact Sri Lankan Tamils consider themselves superior to their Indian cousins (Thambiah 1986) believing that Sri Lankan Tamil culture, unlike the Tamil culture in Tamilnadu, has not been corrupted by Sanskrit influence. For them the Indian connection, prior to the escalation of ethnic conflict, was more an instrumental link than an emotional bond. Instrumental because it provided them with an easy access to education for their children in educational institutions in Tamilnadu. This became more significant than ever when Sri Lanka moved towards favoring the majority Sinhalese in educational opportunities in the early 1970s (de Silva 1974). In addition there are

economic linkages, both formal and informal, that link India, mainly South India, with Sri Lankan Tamils. One of the most important of these linkages is the smuggling network that exists between Tamilnadu and the Jaffna peninsula. It has established a very strong network of informal and clandestine relationships between coastal villages in Tamilnadu and coastal villages in Jaffna. The leader of the most powerful Tamil guerilla group, the LTTE, and most of its other top leaders come from the Jaffna coastal line that is notorious for its smuggling activities.

The Indian Tamils who were brought into Sri Lanka by the British to work in the tea plantations not only have close social and economic ties with India but also are regarded by Indians as partly their responsibility. Until recently they were considered Indian citizens by the Sri Lankan government.⁸ The close association between the Plantation Tamils and the Tamilnadu society is clearly seen in the former's political work during the 1960s when Tamil separatism was active in South India. The Plantation Tamils also had their branch office of the South Indian separatist party in Sri Lanka. Therefore, prior to ethnic conflict the Tamils of recent Indian origin, i.e., the Plantation Tamils, were the group that were concerned with the Indo-Sri Lanka ethnic link. Though there are ethnic links between Sri Lankan Tamils and the Tamils in India, they became important only in the 1980s as part of the ethnic conflict.

The transnational ethnic linkage between India and Sri Lanka has another important aspect to it. This relates to the poly-ethnic nature of Indian society. The Indian diaspora in Sri Lanka, i.e., the Tamils, are not part of the majority ethnic group in the Indian society. So the link in this case is between a minority community in Sri Lanka and a minority community in India. Of the number of communities which form the Indian polity, Tamils themselves are in conflict with the majority ethnic group that is in power in India. The conflict is based, to large extent, on the use of language, that is, Hindi vs. Tamil, and on territoriality, that is, the North vs. the South, and perceived origin, that is, Aryan vs. Dravidian. The Hindi-speaking group that comes from the North and is Aryan in perceived origin dominates Indian politics. Tamils come from the Dravidian South, which is constantly in conflict with the attempt by the Northern Hindi belt to dominate Indian polity (see Mason, 1967 for details). The Indian identity, which is largely a result of the anti-colonial struggle, does not play a significant part in domestic Indian life. How could one explain the involvement of India as a whole in the conflict on behalf of a group with which the majority group itself is in conflict is a question that needs to be explained. The explanatory value of the ethnic variable is limited. Therefore one has to look for alternative explanations that go beyond ethnic links yet are associated with them. This is where the interaction between interest factors and ethnic loyalties become important.

⁸ The Tamils of recent Indian origin were deprived of citizenship and as result disfranchised by the first post-independent parliament. However a series of Indo-Sri Lanka agreements and political agreements between the government and leaders of Plantation Tamils have resulted in either these people being repatriated to India or given Sri Lankan citizenship. For details see Kadian (1990) and Dube (1989)

The first indication that the Tamil separatist movement intended to use extra-national support for its struggle and was planning to mobilize ethnic links overseas came when Messrs S.J.V.Chelvanyakam and A.Amirthalingam, the leader and the leader designate respectively at the time, of the Federal Party of Sri Lanka, declared in February 1972 in Madras⁹ in India that "they plan to fight for full independence for Tamils in Sri Lanka and would need not only the support of the people of Tamilnadu but also the people of India" (Tremayne, 1988:p.396). Though one may discard this statement as mere rhetoric, the timing of it is significant, as it was made just after the conclusion of the Indo-Pakistan war in which India helped the East Pakistani guerrillas to secede from Pakistan.

Though there have been occasional protests by India through diplomatic channels on behalf of the Tamil community in Sri Lanka, particularly for the plantation Tamils, (Kadian 1990:86-87pp) India got directly involved in the ethnic conflict in Sri Lanka only in the 1980s. India's active involvement in the Tamil separatist struggle in Sri Lanka since 1983 is no secret (Kadian, 1990; Greenberg, 1986; O'Ballance, 1989), though her leaders always emphatically denied giving military assistance to Tamil militants fighting the Sri Lankan armed forces¹⁰. Indian leaders, however, always openly declared that India has a role to play in the Sri Lankan conflict, as the conflict in Sri Lanka affects India's external relations, i.e., security concerns and domestic politics. To understand the Indian role in the Sri Lankan conflict, therefore, one needs to examine both India's position in the region as the regional power and also its domestic politics.

India is the biggest and the most powerful country in South Asia, and the Indian hegemony in the region is implicitly recognized by everyone, including the US administration, which until recently has been somewhat wary in recognizing India's hegemonic role in the region.¹¹ The Indian foreign policy with regard to the region is determined basically by two factors. The first is its position as the de facto regional super power. This makes India very sensitive to activities by outside powers that would

⁹ Madras is the capital of Tamilnadu, the South Indian state with a Tamil majority. The state always returns a regional Tamil nationalist party into government. It had its own separatist movement in the 1950s and 60s.

¹⁰ Indian involvement in providing military assistance to Sri Lankan Tamil groups according to some observers started around 1984. Some Indian officials have gone far as to say that India may have turned a blind eye to military assistance given by Indian parties. But there are well informed allegations that the Indian government under Mrs. Gandhi armed militants (Greenberg, 1986). Kuldip Nayar (1992), a respected Indian journalist, says that India trained the LTTE cadres, financed and armed the movement.

¹¹ Mr. George Bush, then Vice President, in his visit to New Delhi in May 1984 stated that India was the "pivotal power" in the region (De Silva, 1984:p.3).

question India's hegemony in the region. The second is India's relationship with Pakistan, which it sees as hostile to India, and with China, which is trying to establish herself as the leader of the third world, a role India would dearly love to have. India has therefore always been sensitive to the foreign policies of its neighbors. The behavior of her small neighbors who always rallied together fearing Indian domination in the region does not help reduce India's concerns. In addition it also must be noted that Indian role in the region is influenced by the personality of the leader (Greenberg 1986). For example, Mrs. Gandhi pursued a very aggressive regional policy that displeased all her neighbors, while her son who succeeded her was more accommodating yet continued the same role. The present Indian leader seems to prefer not to get involved.

The Indo-Sri Lanka relationship always had its share of problems. Sri Lanka has long standing close diplomatic ties with China and is also a close ally of Pakistan. During the border war between India and China in 1964 Sri Lanka remained neutral, which undoubtedly displeased India. During the Indo-Pakistani war in 1972 that was the Bangladeshi liberation struggle, Sri Lanka offended India by allowing Pakistani planes to stop for fuel in Colombo airport on their way to Bangladesh to fight both Bangladeshi guerrillas and the Indian forces. Further, there is a boundary dispute between the two countries, which was settled finally in 1973 in an agreement on the maritime boundary, but the residuals of the dispute still remain.¹² In addition disagreements regarding the treatment of Tamils in Sri Lanka, especially the Indian Tamils, have always been a feature of Indo-Lanka relations (Kadian, 1990).

The foreign policy dimension of the Indo-Lanka relations is very important to understand the behaviour of the Indians towards Sri Lanka. Sri Lanka, though was friendly with the Pakistanis and had a very special relationship with the Chinese, followed a non-aligned foreign policy up to 1977. After 1977, though Sri Lanka remained in the Non-Aligned Movement, its policies became clearly pro-West. This no doubts have irked the Indians who, until recently at least, looked at the West with suspicion fearing that the West, especially its leader the United States, is pro-Pakistani and also a challenge to India's hegemony in the region. The pro-West stance of Sri Lanka is clearly demonstrated by its support for Britain during the Falkland war, which was criticized by the rest of the non-aligned countries. Further, in 1983 the Sri Lankan government concluded a new agreement allowing the United States to increase broadcasting capacity of the V.O.A. transmitting station in the island. Thus, the relations between the two countries that were never good turned worse after 1977, with Sri Lanka's clear shift towards the west, reached a crisis point with the escalation of the separatist struggle in the country.

The above discussion demonstrates three important aspects of the Indo-Sri

¹² This dispute was about an island in the North of Sri Lanka used by both fishermen from Tamilnadu and Sri Lanka as a temporary boat yard during the fishing season. It also has a Hindu temple which is considered by South Indian Tamils as proof of its Indian connection. Though the dispute is now officially settled, whenever there is dispute relating to Sri Lanka, the Tamilnadu government brings this issue up again.

Lankan ethnic links. The first relates to the ethnic link between India and Sri Lanka as it is projected today. Prior to the 1980s Sri Lankan Tamils were not a major part of the link. Secondly, it shows that India has both foreign policy concerns and domestic concerns with regard to Sri Lanka. Thirdly and most importantly, the Indo-Sri Lanka ethnic link is not a link with India, but with a community in India. The transnational links based on ethnic loyalty with the Sri Lankan Tamils made the Sri Lankan separatist problem a powerful domestic issue for India. But ethnic links are not the only reason for Indian involvement in the Sri Lankan conflict. These linkages provided the basis for Indian intervention in the Sri Lankan conflict, an intervention that also served its foreign policy concerns. These links helped India, which was eager to have some leverage in Sri Lanka. On the other hand the links also helped the Sri Lankan Tamil groups which were looking for resources to continue their struggle, and also provided Tamil politicians in Tamilnadu a ready-made, attractive election issue to appeal to voters. My argument, therefore, is that the links were exploited and manipulated by the Indian government and mobilized by the Sri Lankan Tamil ethnic separatist movement as well as by the politicians in Tamilnadu. In other words the Sri Lankan Tamil separatist movement mobilizes resources available in the Indian context, both in Tamilnadu and in relation to the central government, and ethnic linkages are an effective basis for that action. This is the reason for the salience of ethnicity in the relationship between India and Sri Lanka in the recent past. As a result, since 1983 the Tamil problem in Sri Lanka has become an integral part of India's domestic politics.

Indian Domestic Politics and the Ethnic Conflict in Sri Lanka

The foregoing discussion showed that Indian strategic interests that conflict with Sri Lankan policies and the existence of ethnic linkages with the Tamil-dominated state in India are being used by the Sri Lankan separatist movement to mobilize existing ethnic linkages with India. At the same time the Indian central government also uses the Tamil groups for its benefit. Last but not least, for the politicians in Tamilnadu, the Sri Lankan Tamil conflict gave an effective means to reach their electorate. To understand these relationships and the resultant process of mobilization of ethnic links it is necessary to examine several sets of relationships, namely, the relationship between Tamilnadu politicians and the Sri Lankan Tamil separatist movement, the Tamilnadu public and the Sri Lankan Tamil movement, and finally, the relationship between Tamilnadu government and the central government of India.

From the beginning there has been a very close relationship between Tamilnadu politicians and the Sri Lankan Tamil groups. Different groups have cultivated special working relationships with different politicians in Tamilnadu. The two most noted

alliances are the one between Mr. M.G. Ramachandran¹³, who was then the Chief Minister of Tamilnadu and a partner of Mrs. Indira Gandhi's government, and the most dominant Tamil militant group, the Liberation Tigers of Tamil Eelam (LTTE), and the one between Mr. M.Karunanidhi, the opposition leader whose party later became affiliated with the new government that came with the defeat of Rajiv Gandhi, and the Tamil Eelam Liberation Organization (TELO) (Wilson, 1988:p.204). But these alliances were not permanent. They changed with changes of political and other interests. When TELO was decimated by the LTTE in 1986 (O'Ballance, 1989:pp61-62), Mr. Karunanidhi got close to another group called the Eelam People's Revolutionary Liberation Front (EPRLF). When the LTTE turned against the EPRLF in 1989 and killed its leaders and most of its cadres, Mr. Karunanidhi became somewhat distanced from the militants. Similarly, the relationship between M.G.Ramachandran and the LTTE became strained after the Indian peacekeepers started fighting the Tamil groups. This gave an opportunity for Mr. Karunanidhi, who was a sworn enemy of the LTTE, to approach the group. For the LTTE also it was an opportunity, as it was losing sympathy in India. This rapprochement continues even today. The Tigers are today in conflict with Mr. Ramachandran's party and have even threatened to assassinate Ms. Jeyalalitha, who is Mr. Ramachandran's heir apparent and the present Chief Minister in Tamilnadu.

This situation highlights another important dimension of the links that connect Sri Lankan Tamils with the Tamils in Tamilnadu. It shows that there is rarely any unity among the groups on the issues concerning them. The Sri Lankan Tamil militant movement is divided on the basis of ideology and shows even personality differences.

¹³ The first Tamilnadu political leader to openly support the Tamils in the ethnic conflict in Sri Lanka was however Mr. M. Karunanidhi. This was during 1981 ethnic riots in Sri Lanka and Mr. Karunanidhi was the opposition leader of the Tamilnadu State Assembly. Then Chief Minister of Tamilnadu Mr. M.G. Ramachandran (he was borne in Sri Lanka) who came to be known as the God Father of the Liberation Tigers of Tamil Eelam did not choose to get actively involved at the beginning. It is even rumored that he helped the Sri Lankan government to trace Tamil militants operating in Tamilnadu. He even banned the protest rally organized by Mr. Karunanidhi in 1981 to show solidarity with Sri Lankan Tamils. Clearly Mr. Ramachandran was not fully aware of the political value of the Tamil conflict in Sri Lanka for him. This illustrates that ethnic link was not the only reason for involvement of Indian groups.

Caste has also played a role in the formation and operation of the militant activities.¹⁴ The other actor, i.e., the politicians in Tamilnadu, are also divided on the basis of caste and most importantly along party lines, which again is based on socio-economic and even personality factors. Because of this there have been only rare instances in which all groups came together to help the Sri Lankan Tamils. This normally happens only when there is a heightening of tension in Sri Lanka and Tamil groups are losing their position. For example during the 1983 ethnic riots all South Indian Tamil political groups came together to pressurize the Indian central government to intervene in Sri Lanka. Again in 1987, when the Sri Lankan government was about to take Jaffna, they got together, and that resulted in India sending its army to Sri Lanka. On other occasions, however, the groups are more in conflict than in agreement, and this has, in a way, made the task of the Indian central government's role with regard to Sri Lanka somewhat complicated. On the one hand it has allowed the Indian government to manipulate the groups. On the other hand, it has made the situation less predictable, and the central Indian government has always to take extra care to properly balance the needs of all parties with regard to the Sri Lankan conflict. These events clearly show the relationships between the politicians and the members of Tamil groups is something based on mutually advantageous interests and opportunities. Ethnic links only facilitate their relationship.

These contacts translate into political, moral and financial backing for the Sri Lankan Tamil movement, while for the Tamil politicians in Tamilnadu they can be exploited in canvassing for votes. The role of these contacts affect not only Tamilnadu politics and the Tamil military struggle in Sri Lanka, but also Indo-Sri Lanka relations. For example, after the 1983 riots Mr. M.G. Ramachandran, who was the Chief Minister of Tamilnadu state, went to meet Mrs. Gandhi to request for Indian intervention in Sri Lanka on behalf of the Tamils to restore law and order, but she was not prepared to take direct military action. She instead offered help to Mr. J.R. Jayawardene, the President of Sri Lanka, to solve the problem through Indian mediation and stated that India did not support any breakup of Sri Lanka. Mr. Ramachandran had to be content with organizing a one-day strike. When India refused support for Tamil aspirations by sending its military to Sri Lanka, Mr. Karunanidhi, who was then opposition leader, walked out of the Tamilnadu State Assembly. Meanwhile P. Nadumaran, the leader of the Congress

¹⁴ I do not want to argue that the militants are divided on caste basis. However caste has played a role in the formation of the militant movement. In addition to the problems Tamils face in Sri Lanka as a minority, which no doubt is the single most important factor in the rise of the Tamil militancy, the rigid caste structure also played a part. The militants were, for example, fighting the *vellala* dominated Tamil politics as well. There are ideological divisions separating groups. For example, the LTTE is nationalistic and chauvinist while the EPRLF is socialist. There were also regional factors influencing divisions i.e., LTTE coming from Jaffna and the EPRLF from the eastern parts of the country. The PLOTE LTTE conflict originated basically a personality clash between two founding members who fought it out in Madras (Greenberg, 1986) but again has ideological and caste basis.

(Kananrai) Party, assembled about 5000 supporters to start a march called a *pilgrimage of sacrifice* from Madurai to Rameshwaram to sail to Sri Lanka. A ship was hired for the event, but, the Indian government banned its sailing. Mr. Nadumaran abandoned the project after Mr. Amirthalingam, the leader of the Tamil United Liberation Front, appealed to him not to go ahead. Still there was a symbolic boarding of the vessel for the benefit of the media (O'Ballance, 1989:p.27).

In addition to the politicians, the Tamil movement depends heavily on the public in Tamilnadu. This relationship is very much an ethnic loyalty, but it also not without its share of interests. There were interest cum ethnic issues such as the disputed island of Kachative (see footnote 10). As mentioned before, there is a close interaction between the Tamil villages in Jaffna and the coastal villages in Tamilnadu in the area of smuggling. These are also reasons for the people in Tamilnadu to provide shelter and moral support to the Sri Lankan Tamil separatists living in Madras and involved in political work. The ethnic kinship that binds the two peoples was effectively exploited by the separatist movement. The involvement of Tamilnadu public in the Sri Lankan conflict is particularly seen after the 1983 ethnic riots in Sri Lanka. The atrocities allegedly committed by the Sri Lankan army, the killings by Sinhalese mobs, and also the hard line attitude of the government during this period helped the Tamil militants operating in Tamilnadu to incite anti-Sri Lanka feelings among the masses. One of the aims of the propaganda machine of the separatist groups was to incite emotions among the masses, they did not require much effort there, to use them as a lever in getting politicians in line. Therefore it is valid to state that Tamil separatism depended on ethnic mobilization in India, which was effectively carried out by different groups involved in the Sri Lankan conflict.

The result of these linkages is the Sri Lankan Tamil struggle became part of Indian politics through its surrogate, the Tamilnadu government. The group Tamil Eelam Liberation Organization was formed in India in 1975. The Liberation Tigers of Tamil Eelam (LTTE) took their struggle to Tamilnadu and established bases there. Later other groups also joined in both for political work and military training provided by the Indian government. The Indian government's involvement in giving training to militants came as a result of India's interest in manipulating the situation for its security concerns as well as on the insistence of the Tamilnadu government¹⁵. To understand this therefore we need to look at the relationship between Indian government and the Tamilnadu government. The main variable here is the indispensability of the Tamilnadu government for the center, whatever the party in power.

¹⁵ The support of the Indian central government of India for Sri Lankan groups came both as a result of pressure by the Tamilnadu politicians and India's own interests. However the military training given to the groups was organized for India's security interest alone. The fact that India was selective in giving military training, and most importantly, did not choose to train the LTTE (South 1985 p.13) which always followed an independant line shows that India was trying to safegaurd its interests by arming the militants than strengthening the Tamil struggle in Sri Lanka.

Since the death of Nehru all governments in the center have aligned with one of the two Tamil regional parties¹⁶ in Tamilnadu to get a majority in the *Rajya Saba*, which is India's House of Representatives. Further Tamilnadu also had a strong separatist movement till 1960, and India does not want it to come up again. This makes the Indian government sensitive to demands of Tamilnadu. It becomes more important when demands are about their cousins in Sri Lanka. For example, though the central government of India rejected the appeal by Tamilnadu to intervene militarily in 1983, the pressure of Tamilnadu in July that year forced the Indian government to release several Sri Lankan Tamil militant leaders who were in custody (Ram, 1983) as a mark of protest, and to issue a strong protest saying that "India could not sit idly by because people of Indian origin were affected" (Greenberg, 1986). This was followed by a special mediator to Sri Lanka to bring the two warring parties to the discussion table (Greenberg, 1986). Yet the real Indian intervention came only in 1987, with the arrival of the Indian army in Jaffna under the Indo-Lanka accord of 1987.

The Indian Military Involvement in Sri Lanka.

India sent military forces to Sri Lanka to help make peace between the two warring groups in 1987 under the Indo-Lanka Agreement signed in September that year. The army that was initially sent in as peace keepers later was drawn into a fully-fledged war with the Tamil militants. The Indian military operation in Sri Lanka was not the beginning of Indian military role with regard to Sri Lankan ethnic conflict. It began long before the actual landing of Indian army in the island, with the Indian government's clandestine training of Tamil militants in Tamilnadu with the cooperation of the Tamilnadu government. Though actual records of the operation is sketchy, it is believed Indian training of Tamil guerrillas in Tamilnadu commenced soon after the 1983 ethnic riots (Greenberg, 1986).

The ethnic riots in Sri Lanka in July 1983 resulted in Indian government providing open support for the Tamil groups that were already operating on Indian soil e.g., in Madras- with covert Indian support. As stated earlier the state government in Tamilnadu provided the militants with residences, offices, telephone and other logistic support. They were allowed to move in Madras, often in combat uniforms, giving interviews to media and relaying radio orders to field commanders in Sri Lanka. The Indian central government provided former Indian Army personnel as instructors (O'Ballance, 1989:p.31). Indian military training to Tamil guerrillas was provided mainly because it served India's domestic political interests and national security interests. Sri Lankan conflict was creating problems in Tamilnadu and India therefore

¹⁶ This does not mean that the ruling party in the center could never get a majority in the parliament in the center since Mr. Nehru's death. To get the majority, however, most of the time the major parties have to come into no contest pacts with regional parties. One of the most important regional vote banks in this context is Tamilnadu. The two major Tamil parties in Tamilnadu have had coalition agreements with all ruling groups since Mr. Nehru's death.

had to do something to keep Tamilnadu happy. Further, purely for domestic reasons India did not want Sri Lanka disintegrating as a result of ethnic conflict as it would create a precedence and in turn would influence India which is a federation of ethnically based states. In the area of national security India wanted to have Sri Lanka in check and believed that an Indian-controlled guerilla movement would be the ideal way of doing it. For this purpose the Indian government approved the training of militants by the Research and Analysis Wing (RAW), which is India's equivalent to the CIA. Thus the training of militants is an extension of India's foreign policy towards Sri Lanka on the one hand. On the other it also reflects the domestic political concerns, especially with regard to Tamilnadu. This makes India's situation with regard to Sri Lanka's conflict a very complex one. First there are security interests of using the conflict for its advantage to maneuver the neighbor. Second there is regional pressure from Tamilnadu to intervene. Third is the wider domestic concern of not legitimizing ethnic separatism that would finally be a problem to India. India therefore had a real balancing act to perform with regard to the conflict in Sri Lanka.

When the Indian army first came to Sri Lanka under the 1987 Indo-Lanka agreement they were seen by the Tamils as saviors. They were welcomed with open arms by the civilians in Jaffna. Though the militants were not very enthusiastic about the fact that they were forced to surrender arms -in fact the Liberation Tigers of Tamil Eelam (LTTE) did not surrender their weapons- there was all round jubilation about the arrival of Indians in Jaffna. In the south of the country the story was different. The Sinhalese saw the Indo-Lanka agreement as something that had been forced on Sri Lanka. They rejected the accord and there were mass protests against the agreement. There was genuine fear among the Sinhalese that the Indians would ill treat the Sinhalese living in Tamil-majority areas and would finally help the Tamils to achieve Eelam. The events that preceded the agreement, namely the Indian food drop in Jaffna and Indian High Commissioner's forceful style of doing business with Sri Lanka during the Indian military operation in Sri Lanka, made Sinhalese feel Indians were against Sinhalese. This brought into question the legitimacy of Indian Intervention.

Though Indians expected to complete their work under the Indo-Lanka agreement and leave soon, it was not to be. Even before signing, the agreement was doomed to failure. The main militant group among the Tamils, the LTTE, was not willing to accept the agreement, saying it did not go far enough, but they were pressurized by Mr. M.G.Ramachandran and Mr. Rajiv Gandhi to accept the agreement (Kadian 1990). It is said that India paid the group 10 million Sri Lankan rupees as compensation for accepting the accord. After a few days of Indian presence, however, the troubles began. The Sri Lankan navy arrested a group of Tamil militants crossing from India to Sri Lanka with arms. The Tamils wanted them to be released under the general amnesty given to militants under the Indo-Sri Lanka agreement. The Sri Lankan government refused, saying that the militants were breaking the peace agreement by transporting arms to Sri Lanka, which was banned under the accord. During the negotiations between India and Sri Lankan on the crisis the arrested militants committed suicide by swallowing cyanide. That sparked the confrontation between the Tamils and the Indians. This resulted in the LTTE taking a television crew of the Sri Lanka Broadcasting Corporation in Jaffna hostage and killing all of them. As the hostilities

increased the Indians had no alternative but to intervene and disarm the militants.

The Indian military operation that began with these incidents in the country can be divided into two stages. In the first stage it was a conventional war with the dominant Tamil group with the aim of capturing the areas under the control of the militants. This was accomplished by the Indian army with relative ease within about two months (Kadian, 1990). This is no surprise considering the Indian manpower and firepower. During the peak of the fighting the Indians were said to have had over 100,000 soldiers in the country, though India always insisted that it had only 52,000 (Kadian, 1990). The second phase of the struggle came after the Indians captured rebel-held towns and pushed the rebels into jungles. This was the start of the guerilla war that India could not win. Finally after two years of fighting and over 1000 deaths the Indians agreed to withdraw from Sri Lanka in 1990. The withdrawal was completed in April 1990, ending a new chapter of Indian involvement in Sri Lanka.

The Impact of the Indian Military Operation on Indo-Sri Lanka Transnational Relations.

When India withdrew from the island the Indo Lanka relations were taking a new turn. Indians had almost lost all sympathy among the Tamils by 1990. The civilians who welcomed them in 1987 now saw them as an invading army even worse than the Sinhalese. There were numerous stories of Indian soldiers raping women and killing innocent civilians. Of course some of these stories may have been the creations of the LTTE for the purpose of propaganda to discredit India, something they had been known to do during the army operation by the Sri Lankan government. In fact killing civilians was the main charge against the Sri Lankan army. Now the same charges are leveled against the saviors themselves. The activities of the Indian army had repercussions in India, especially in Tamilnadu. The Tamilnadu government was in a dilemma here as it was not sure where its loyalty was. Both politicians and the masses in Tamilnadu did not understand what the Indian army was doing by attacking the militants. That was not what they expected. They came to realize that the interests of the Indian government and the interests of Tamilnadu do not always coincide with regard to the conflict in Sri Lanka. Yet their wider loyalties with the Indian nation did not allow them to criticize Indian action outright. Doing that when Indian soldiers were being killed would mean being a traitor to the Indian nation itself. This is something most Tamilnadu politicians wanted to avoid. Still there were protests in Tamilnadu faulting the Indian operation. The opposition party in Tamilnadu issued a statement during the time declaring that " Tamils in India will not remain silent witnesses to the liquidation of their brothers in Sri Lanka by the Indian army" (O'Ballance, 1989: p.103). This time, however, the attempts by the opposition leaders to make it a political issue did not bring desired results. There was no support of the masses, unlike in 1983 when there were large scale agitations.

The public were in a dilemma trying to sort out their loyalties.¹⁷

I mentioned that the transnational ethnic link between the Tamil community in Sri Lanka and Indian society is an indirect one because it is not a link with the majority ethnic community in India. This situation became clearly evident during the Indian operation. Tamilnadu became increasingly uneasy about the Indian central government's handling of the Sri Lankan operation. The Indian operation in Sri Lanka questioned the loyalty of Tamilnadu to greater Indian society and also greater Indian society's responsibility to minorities. It also affected the relationship between Tamilnadu politicians and those in the central Indian government. This heralded a new era of Tamilnadu's relationship with the Indian center as well as Tamilnadu's relationship with Sri Lankan Tamils. It clearly brought home the message to Tamilnadu that wider interests are the driving force behind India's foreign policy and there is a limit to Tamilnadu pressure. As stated previously, the lack of unity among Tamilnadu politicians and the masses helped the central government. Throughout the Indian operation Mr. Ramachandran and his party, which was in power in Tamilnadu then, strongly supported the central government's policy towards Sri Lanka. Joining with the central government the Tamilnadu government imposed restrictions on Sri Lankan militants operating in Tamilnadu. These restrictions continue even today.

The Indian military operation did not help solve the Sri Lankan ethnic problem, nor did it help Indian interests in Sri Lanka. It only changed the nature of Indo-Sri Lanka transnational links. During the military operation we can see that the relations between Indian government and Tamil militants deteriorating. It also affected the relationships between Tamilnadu government and the Indian central government, a fact we have discussed already. Finally the relationship between the Tamils in Sri Lanka and Tamils in Tamilnadu was also affected. Therefore the Indian operation can be said to have elevated the Indo-Lanka transnational links to a different level. It redefined the links and as a result contributed to a change in the equation of Indo-Lanka relations. The war made it was difficult for Tamilnadu to defend Sri Lankan Tamils. They were now fighting the Indians. One who defends the enemies of your army is an enemy. That was a dilemma for the Indian Tamils. Though there were protests against operations by the Army by sections of Tamilnadu politicians the mainstream kept away. The facilities for the Sri Lankan militants to operate freely in India became restricted as a result of the government restricting access and people becoming unwilling to extend support. With this came the peace talks between Sri Lankan government and the LTTE. Cause of this was the anti-Indian sentiments of both parties. This further aggravated the situation in

¹⁷ The lack of unity in Tamilnadu, owing to the fact the Indian intervention resulted in conflicting loyalties, made the task of the Indian government relatively easy. The politicians in Tamilnadu were divided and so were the masses. The unity of the two groups is important if they want to bring real pressure on the central government. The best example is the effective mobilization of Tamilnadu pressure in 1983 and afterwards up to Indian military intervention. During this period Tamilnadu was united on one issue, that India should intervene to help Tamils in Sri Lanka.

India and it became more restrictive for the Tamils.

The Indian military operation in Sri Lanka affected Indo-Lanka ethnic links. It weakened the ethnic link between Tamilnadu and Tamils in Sri Lanka. Most importantly the operation resulted in practical problems for Tamil militants operating in Tamilnadu as the governments, both central and Tamilnadu, imposed restrictions on access to resources in India for the militants. These restrictions became stronger after the killing of Mr. Rajiv Gandhi, allegedly by the LTTE. After Rajiv Gandhi's death India instituted criminal proceedings, indicting several LTTE leaders including its leader Mr. Prabaharan and imposed a ban on the LTTE. Though the ban is only on the LTTE the other Tamil groups also find it difficult to operate on Indian soil, mainly because they no longer have the same sympathy of the people of Tamilnadu, and as a result politicians do not find them the asset they were in the early stage of the struggle. This has made India's task in the Sri Lankan conflict some what easy. India today does not have the same domestic political pressure to intervene to help the Tamils, because on the one hand, politicians do not find in the Sri Lankan Tamil problem a ready made political asset free of any liabilities as in the past. In fact the Sri Lankan Tamils have become more a liability than an asset to Indian politicians in general and Tamilnadu politicians in particular. This situation is partly a result of Indian army involvement and the subsequent killing of Rajiv Gandhi.

One could, however, argue that Indian hegemony is now established in the region as a result of the changing geo-political equation, and therefore India does not have the same anti-US feelings as before. This could also be a reason for Indian disinterest in getting involved in Sri Lanka's affairs today. I do not agree. Though United States has better relations with India today, all is not well between India and the United States and India is still sensitive to US involvement in the region. For example, the recent agreement by Sri Lanka with the US to expand the activities of Voice of America by upgrading its relay station in the country met with strong Indian protests. This is one example that shows that changing world power relations have not altogether changed Indian attitude towards outside interference in the region. Further, Sri Lanka has decided go ahead with the project in spite of Indian protests and India failed to prevent it. This incident suggests that India did not achieve any significant security goals by intervening in Sri Lanka. India is not even in a position to use the ethnic link as it did some time ago to pressurize Sri Lanka, because it weakened the links by attacking Tamils during the Indian army operation. Tamils in general and Tamil militants in particular, namely the LTTE, do not trust India the way they did before the intervention. We may conclude that Sri Lankan Tamils and Indians both, at least temporarily, lost more than they gained from the Indian military adventure in Sri Lanka.

Interest Factor in the Indian Involvement in the Sri Lankan Ethnic Conflict

Though ethnic links and loyalties are part of intervention by a third party, when it comes to the crucial question of state interests vs. ethnic loyalties, the interests of states supersede their commitment to diasporas. Esman (1986: p 348) is correct here when he says that foreign policy interests supersedes the commitment of states to their diasporas. The Indian involvement in Sri Lankan conflict from the beginning demonstrates this clearly. For example, India never wanted a divided Sri Lanka, though

it no doubt wanted to have a say in Sri Lanka's foreign policy. The Indian support for the Tamil militants has always been a balancing between Indian foreign policy and security concerns and domestic political concerns. The crucial turning point that demonstrated the primacy of the foreign policy interest factor came into the open during the Indian peace keeping operation in Sri Lanka. When the dominant Sri Lankan Tamil militant group refused to toe the Indian line, Indians declared war on them, which in turn led to a bloody war that killed the civilians they came to rescue. What is abundantly clear is that the intervening state always tries to balance between ethnic interests, which are part of domestic politics, and its foreign policy concerns. As shown in this essay with regard to the Indian intervention in Sri Lanka foreign policy concerns clearly became the major factor in the shaping of the Indian role in the ethnic conflict in Sri Lanka.

Foreign policy concerns are, however, not the only factor that interacts with ethnic linkages in determining the external involvement in domestic ethnic conflict. This essay also showed that purely domestic interests can affect the commitment of the home country to its diaspora. The immediate and non-ethnic interests of the ethnic kins in the home country for example, can influence the way the home country reacts to the plight of its diaspora. In the case that was examined here we saw that the masses in Tamilnadu and also Tamilnadu politicians putting their immediate domestic concerns first when it came to a choice between the Sri Lankan ethnic conflict and what was advantageous for themselves politically in Tamilnadu. Thus, the support for the Tamil groups in Sri Lanka itself has always been partly influenced by the domestic politics in Tamilnadu. For example, Mr. Karunanidhi, who was the opposition leader during the Indian involvement always demanded that India was not doing enough to help the Tamils in Sri Lanka. Later when the Indian government in the center changed and a group that had support of Mr. Karunanidhi's party came to power in the center, he became more restrained in his demands.

Interest factors also played a major role in the links between Tamilnadu politicians and Sri Lankan Tamil militants. The support for various groups by different political parties shows a similar situation. For example, Mr. Karunanidhi always supported the Sri Lankan Tamil group the Tamil Eelam Liberation Organization (TELO), while Mr. Ramachandran was the patron of the Liberation Tigers of Tamil Eelam (LTTE). After the killing of Rajiv Gandhi, however, Mr. Ramachandran's party, now headed by Ms. Jayalalitha, distanced itself from the LTTE, and Mr. Karunanidhi came close to it abandoning the TELO group. These changing loyalties and connections is only part of the complexity of the issues involved. It though is sufficient evidence to prove that ethnic loyalty takes a back seat when it comes to the crucial question between the diaspora and the interest related to the survival of the home country co-ethnics themselves. In addition the behaviour of the politicians in Tamilnadu during the Indian military operation that is, the lack of unity among them in their support with the Tamils in Sri Lanka, further supports the above line of reasoning. By the time the Indian operation began, the Tamil problem was beginning to lose its appeal in Tamilnadu. This partly explains the lack of unity in Tamilnadu in its support for their co-ethnics in Sri Lanka. In this case as in others, ethnic loyalties were primarily a means used by interest groups and other actors.

A brief examination of the Indian intervention in the war of liberation of Bangladesh from Pakistan in 1971 and the Indian intervention in Sri Lanka will help us further understand the relative importance of the major variables, namely, the diaspora link (ethnic factor) and domestic and foreign policy concerns (interest factor) associated with external involvement in domestic ethnic conflict. In the case of Bangladesh, India was willing to go all the way in supporting Bangladesh's desire to separate from Pakistan, despite the fact that there was no strong ethnically determined agitations asking the Indian government to support in the Bangladeshi militants.¹⁸

This does not mean to say that there was no pressure from the Indian side to intervene in the conflict. There was pressure, but it came mainly from people who were concerned about the human rights violations by the Pakistani army and the people of Indian states bordering East Pakistan, which faced a massive influx of refugees. By contrast, in the case of Sri Lanka, in addition to the refugee problem and the human rights issues, there was a clear ethnic link between Tamilnadu and Sri Lanka. India did not, however, favour a separate state in Sri Lanka for the Tamils and the direction the Indian intervention took is ample proof of India's unwillingness to help the Tamils to get their own country. Why did India behave differently in the two situations is the question that inevitably comes to ones mind.

There are three factors that explain this differential treatment by the Indians when it came to Sri Lanka and Bangladesh. The first is the lesson learned from the involvement in Bangladesh war. By helping East Pakistan to liberate from West Pakistan and creating Bangladesh India expected to cut Pakistan to size and eliminate the treat India faced in the east. It also expected a grateful neighbor. The events that followed showed that in the long run India failed to achieve both these aims. Shortly after Bangladesh liberation Indo-Bangladesh relations turned sour. This became more and more evident after 1975 when Shiek Rahman was assassinated by the military. (Singh 1987, Hossain 1978, Bindra 1982). Instead of a grateful friend who would sit by India's side it has created another neighbor to deal with. Bangladesh for example has ties with China and has several outstanding disputes with India that are now concerning concern for Indian foreign policy makers. India did not want this to happen in the case of Sri Lanka. Secondly, at the time of India intervention in Bangladesh there was no serious ethnic separatist movements in India threatening the India polity. But in the 1980's India was facing separatist movements of its own in several areas. Creating a ethnically based country in Sri Lanka would have given validity and legitimacy to the claims of these movements. Thirdly, in a paradoxical, but perfectly logical, way the reason that made

¹⁸ It is true that there are cultural bonds between East Pakistanis, as Bangladesh was called then, and the Bengalis in India. It must be noted however that in spite of their cultural similarities East Pakistanis were willing to join with Pakistan to form a Muslim majority state after India gained independence. The ethnic factor therefore has been always determined by religious loyalty which in turn made Bengalis in India not very sensitive to the plight of the East Pakistanis who are Muslims who preferred religion to other bonds prior to the war of Liberation (see Singh 1987 p. 10).

India intervene in Sri Lanka prevented it from following the path it followed with regard to Bangladesh. By this I mean the strong ethnic links between Tamilnadu and the Tamils in Sri Lanka. The very fact that the closeness of these ties made India to think about the possible adverse consequences the Indian polity would face as a result of a Tamil country in northern Sri Lanka. In addition to creating a bad precedence it also would have provided a rear base for now dormant, but not dead, separatist movement in Tamilnadu. India did not want a Tamil state in Sri Lanka as it would provide the rear base for the now dormant separatist movement in Tamilnadu. This helps us to go one step further than Esman's argument (Esman 1986:p. 348) and say that not only foreign policy interests but also domestic interests, where relevant, limit the level of commitment by the home country to its diaspora in a third country.

The discussion has demonstrated the existence of two important aspects of transnational ethnic links, one that has been dealt with some detail by researchers and another yet waiting for recognition. The first is that the transnational dimensions of ethnic conflict is not limited to ethnic linkages based on shared cultural traits and emotional bonds across state borders. The important feature is the mobilization of these linkages by various transnational actors. Traditionally this mobilization is explained in terms of either the home country of the diaspora in question or in terms of the diaspora itself. This study has shown that this explanation is not adequate to understand the whole situation and its dynamics. It demonstrated that neither the home country nor the diaspora community is monolithic in terms of the nature of their involvement in transnational ethnic conflict. There are various interests groups or actors that cut across these two parties and their role is crucial to understand transnational ethnic conflict. Consequently, transnational ethnic links operate within a system of socio-political relationships that are mobilized by different actors. Their interests differ. Further, such mobilization, which has made these linkages salient in the contemporary world, is made possible by these links being part of the socio-political reality through the actors involved. Therefore it is essential that we understand the actors and their interests, if we are to understand the transnational dimension of ethnic conflict.

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Financing The Sri Lankan Conflict

Geoff Harris

1. The costs of armed conflict

Armed conflicts in developing countries occur very largely between a government and opponents who aspire to take over control of the state. These armed conflicts affect countries in a number of ways. There are the direct and indirect human casualties, the latter (much larger than the former) occurring largely as a result of reduced food supplies and access to health facilities. There are longer-term impacts on human beings who have experienced war, including post-traumatic stress and other psychological effects, the loss of skills and the impact of malnourishment in infancy and childhood on subsequent adult productivity. There is loss or damage to physical capital and infrastructure, in part the direct result of war and in part a consequence of disrupted or neglected maintenance work. In a number of countries, the widespread use of anti-personnel mines has rendered former agricultural areas unusable and continues to inflict casualties on civilians decades after the war is over. Environmental damage in some war zones has been extensive and long lasting. A recent review of such costs may be found in Stewart (1993).

This article considers another type of long-term cost which relates to the way in which any particular war is financed. Table 1 outlines the major sources by which a government can finance a war. Governments can raise war revenues internally by increasing taxation and borrowing more from the public. It can release more of its revenue for the war effort by reducing expenditure on other government functions. It can supplement internal sources by tapping foreign savings which, given that they come in the form of foreign exchange, can be used to import military equipment and supplies. It can seek more foreign aid, which will be forthcoming if a donor country supports the government side in the conflict, and which can be used directly or indirectly to finance the war; or it may borrow funds from foreign commercial banks which, again directly or indirectly, may be used to finance the war. It can try to increase exports, although this may be difficult given the disruptions to production likely to occur as a result of armed conflict. Finally, it may divert foreign exchange away from non-military imports.

Each source has its disadvantages: taxation can alienate the population; borrowings need to be repaid in the future and external borrowings require repayment in foreign exchange; reallocation of government expenditures and reduced imports may lead to a deterioration in human and physical capital; increased exports may occur through the exploitation of natural resources at excessive rates and with long term environmental damage; and foreign aid may create political obligations to the donor country.

A point of some importance is that government expenditure on war does not represent the entire financial cost. The opposing forces have their own sources of finance, often less orthodox, but still costly in resource terms to society as a whole. The Khmer Rouge, for example, support their armed forces largely by the extraction of gems and

forest resources from areas under their control; UNITA rebels in Angolia finance arms supplies from the proceeds of diamond smuggling; the Tamil forces in northern Sri Lanka use a range of unofficial tax measures and receive aid from Tamils abroad; and Muhjahideen forces in Afghanistan received extensive aid from both the United States and Muslim countries.

2. Asian armed conflicts during the 1980s

One way of measuring the significance of a conflict is by the number of deaths which result. Table 2 summarizes broad estimates of war-related deaths for major armed conflicts in Asia (those resulting in 20,000 deaths or more) between 1945 and 1992. It is worth commenting here that deaths resulting from structural violence (e.g. malnutrition, disease) occurring independently of armed conflict far outweigh those from war. William Eckhardt (1989), who made the estimates on which Table 2 is based, suggests that structural violence worldwide has killed between 15 and 19 million people (mostly children) in each year of the twentieth century, compared with one million year by armed violence.

Overall, the thirteen Asian countries represented in Table 2 had 7.5 million civilian and 3.7million military deaths over the 48-year period. During the 1980s-the period on which this article concentrates - major armed conflicts occurred in Afghanistan, Cambodia, Indonesia (East Timor), the Philippines and Sri Lanka. Of these countries, there are virtually no data available for Afghanistan and Cambodia for the 1980s. The conflicts in Indonesia and the Philippines are relatively small in terms of their impact on the whole economy, and military data from Indonesia are highly unreliable (Ball 1984a). Data from Sri Lanka, however, has been regarded as relatively accurate and comprehensive, and we therefore focus on this country as a case study in war financing. In brief, the Sri Lankan armed conflict erupted in July, 1983 and involves Sri Lankan military forces against Tamil separatists seeking an autonomous state, principally the Liberation Tigers of Tamil Ealam (LTTE).¹ To date, total casualties are estimated at around 30,000; between June 1990 and December 1991, an upsurge in fighting resulted in an estimated 1500 government soldiers, 3500 LTTE soldiers and 6000 civilians being killed. In 1993, casualties were estimated at a little over 2000 (SIPRI 1994, p.92). This paper is not concerned with the conflict per se, but with its financing.

¹ Up to 60,000 deaths, very largely Sinhalese, occurred in the late 1980s in Southern and central Sri Lanka, as government-sponsored death squads battled supporters of the Sinhalese People's Liberation Front (JVP).

3. Military expenditure data

The principal sources of data used in this article were the Stockholm International Peace Research Institute's World Armaments and Disarmament (SIPRI Yearbooks); the US Arms Control and Disarmament Agency's World Military Expenditures and Arms Transfers 1991-1992 (WMEAT); the IMF's Government Finance Statistics (GFS); and the World Bank's World Development Reports and World Tables. Table 3 reports military expenditure data from several sources. Columns 1 to 3 give estimates of military expenditure in current and constant US dollars. In 1991, WHEAT estimated military expenditure at US\$432 million (column 1). Column 2 and 3 report constant price estimates from WHEAT and SIPRI; there is a broad similarity between the two, although SIPRI's estimates (even allowing for different base years) are much higher for 1986 and 1987, whereas the WHEAT figures are greater for 1988-91. Columns 2,3 and 6 indicate a six fold increase in military expenditures between 1981 and 1991. When it comes to current rupee expenditures (columns 4 and 5), there is a very wide divergence between SIPRI and GFS figures, with the latter being 2.5 times greater. Column 6 presents GFS data in constant price terms.

Table 4 presents military expenditures as proportions of gross national (or domestic) product (GNP or GDP) and central government expenditure (CGE). There is a close similarity between SIPRI and WHEAT as regards the military expenditure/GDP ratio (the 'military burden'), except for 1986 and 1987 when the SIPRI ratio was much higher. The GFS ratio was much lower than the other two until 1985-87, when it was similar to WHEAT; thereafter it was well below the other two sources. Overall, the military burden increased more than three fold between 1980 and 1991 to 4.8 per cent (SIPRI and WHEAT) or 2.7 per cent (GFS). There was wide divergence between the military expenditure/CGE ratios reported by GFS and WHEAT, except for the years 1985-87. GFS data indicates that the ratio increased nine fold, to 17.2 per cent, between 1981 and 1992; WHEAT data suggests a four fold increase, to 15.0 per cent in 1991. For all developing countries, GFS data show that military spending as a proportion of CGE fell from 14.9 per cent in 1980 to 11.8 per cent in 1990.

How might these differences be explained? The GFS data derive from finance statistics correspondents in the relevant government or central bank hopefully in accordance with IMF definitions and procedures, and are generally accepted by the OIMF at face value. WMEAT and SIPRI, however, adjust the official statistics in the light of additional information derived from a range of government and non-government sources. SIPRI uses national budgets and statistical publications, the publications of international organizations, specialist journals, annual reference volumes and newspapers. It gives priority to 'providing a uniform definition over time for each country to show a correct time trend' (SIPRI 1992:269, emphasis original), rather than encouraging cross country comparisons or adjusting figures for single years according to a common definition. Recent SIPRI Yearbooks (e.g. 1992, p269) report a decline in data reliability, over time, despite a considerable increase in the quantity of information available, and the 1993 Yearbook does not include the military expenditure estimates which have been a feature

of the publication since its commencement in 1969/69.

A further point to note is that official military expenditure figures may index-estimate actual expenditures. Nicole Ball (1984a; 1984b) suggests five mechanisms by which this may occur: double bookkeeping; use of extra-budgetary accounts; highly aggregated budget categories; military assistance; and government manipulation of foreign exchange.² The last involves part of the foreign exchange earned by exports not being entered into official trade statistics, and being used by governments for arms imports. Sri Lanka is not among the countries listed as offenders in one or more of these respects, but the research was carried out before the Sri Lankan conflict commenced.

Ball (1984b) has made a close examination of the three main sources discussed here (GFS, SIPRI and WMEAT), together with the International Institute of Strategic Studies (IISS), which publishes *The Military Balance* annually. The IISS is generally regarded as the least reliable (1984b, pp.9-10); WMEAT and SIPRI rely heavily on World Bank and IMF sources (including the GFS); and the IMF accepts on face value the statistics supplied to it by governments (1984b, p.14). Given all this, and the ways used to under-report military expenditure mentioned earlier, Ball compiled her own military expenditure series for 48 developing countries based on readily available data located in the Library of Congress, Washington and in the files of the US Agency for International Development. In her opinion, 'data to exist which are being ignored and which, if properly analysed, could contribute greatly to our understanding of security expenditure in the third world' (1984b, p.34). Her figures for Sri Lanka were derived largely from the annual Estimates of the Revenue and Expenditure of the Government of the Republic of Sri Lanka for the Financial Year and run from 1951 to 1977; they are not therefore useful for purposes of this article. Ball estimated Total Security Expenditure, made up of expenditure on Military Forces plus Police/Paramilitary Forces.³ SIPRI and WMEAT estimates were very similar until 1973 and very close to Ball's figures for Military Forces; they were therefore well below her figure for Total Security Expenditure.

² A recent example concerns IMF attempts to limit military spending in Cambodia to 4 per cent of GDP. The government has attempted to get around this by transferring revenues earned by log sales from the Ministry of Finance to the Ministry of National Defence (*The Economist* (London), August 6, 1994, p.22).

³ Ball (1984b.36) quotes a United Nations definition which includes in paramilitary forces 'those units, formations, etc, that are organized, equipped and behave in a similar way to the armed forces and which could carry out combat actions of the same nature... as those performed by the armed forces.' Between 1951 and 1977, military forces made up around 60 per cent of Total Security Expenditure and police/paramilitary forces made up 40 per cent.

4. Military imports

Part of military expenditure, averaging a quarter of total military expenditure in developing countries, goes on capital expenditure. For most developing countries, such expenditures are made up almost completely of imports of arms and military equipment, and for foreign exchange thus used is not available for other imports, including essential inputs into productive activity. Shortfalls in foreign exchange have to be made up by tapping foreign savings i.e. by borrowing from commercial banks or international agencies, foreign direct investment or aid.

Sri Lanka suffered a severe adverse balance of trade during the 1980s; between 1980 and 1991, imports of goods and services exceeded exports by an average of 51 per cent. Military imports, at face value, made up only a small proportion of total imports: based on WMEAT 1991-91, they were zero prior to 1984 and, from 1984 to 1991, average only 1.2 per cent of total imports; this compares with a figure for all developing countries during the 1980s of 6.9 per cent (Harris 1994a). It should be noted, however, that arms import figures are estimates of a fairly gross kind. As WMEAT (1991-92, p.154) comments,

Frequently, weapons prices do not reflect true production costs. Furthermore, much of the international arms trade involves offset or barter arrangements, multiyear loans, discounted prices, third-party payments, and partial debt forgiveness. Acquisition of armaments thus may not impose the burden on an economy, in the same in other years, that is implied by the estimated equivalent US dollar value of the shipment. Therefore, the value of arms imports should be compared to other categories of data with care.

SIPRI's arms trade data derive from a wide range of sources and cover five categories of weaponry (aircraft, armored vehicles and artillery, guidance and radar systems, missiles and warships). They exclude, for example, small arms and ammunition, artillery under 100mm in calibre and naval patrol craft with a displacement of less than 100 tonnes (unless they carry cannon with a calibre of 100mm or above). Like WMEAT, SIPRI emphasizes the need for caution in placing values on arms imports, emphasizing its use as a device to measure trends in the volume of weapons flows and their geographic pattern, rather than reflecting purchase prices:

The SIPRI valuation system is not comparable to official economic statistics such as gross domestic product, public expenditure and export/import figures. The monetary values chosen do not

correspond to the actual prices paid, which vary considerably depending on different pricing methods, the length of production runs and the terms involved in individual transactions. For instance, a deal may or may not cover spare parts, training, support equipment, compensation, offset arrangements for the local industries in the buying country, and so on. Furthermore, to use only actual sales prices - even assuming that the information were available for all deals, which it is not - military aid and grants would be excluded, and the total flow of arms would therefore not be measured.

(SIPRI 1993,p.520)

Table 5 presents estimates of the values of conventional weapons actually delivered to Sri Lanka between 1987 and 1992. The large difference between SIPRI and WHEAT estimate can be noted. In 1991 US dollars, WHEAT estimates a total of \$241 million for arms imports between 1984 and 1991. Table 6 reports a compilation of SIPRI's listing of arms imports between 1980 and 1993. In summary, 25 naval craft, 85 aircraft, 81 armored vehicles and 18 artillery pieces were delivered during the period. In addition, around 100 armored vehicles have been manufactured in Sri Lanka (ISIS 1988-p.154). The vary large deliveries of equipment in 1991 are clearly not reflected in WHEAT's estimate of arms imports in that year (US\$50m.), and SIPRI data are not presented in annual terms.⁴

5. **Financing military expenditure, 1983-92**

Thus far, we have seen that Sri Lankan military expenditure increased six fold, in real terms, between 1981 and 1991 and that this represented an increase of between four and nine times, depending on data sources, in the proportion which mile made up of GEE. We now turn to examine, recalling Table 1, how this increase in expenditure may have been financed. The words 'may have been' are deliberately chosen. There is no way of being certain of what would have happened to various economic variables if there has been no conflict. All that can be done is to examine the data and indicated possibilities and probabilities. Nor is this examination meant to imply a consistent plan over time on the part of policymakers; they may well be surprised to find that patterns have emerged.

⁴ Recent financial stringency has caused the postponement of some capital works, cancellation of a US\$72 million order for second-hand military equipment from Russia and the Ukraine and a temporary ban on discretionary government expenditure (Far Eastern Economic Review, November 10, p.30).

Increased domestic revenue

In real terms, GFS data show that tax revenue increased by 64.6 per cent between 1980/82 and 1990/91 although the proportion this comprised of GAP remained virtually unchanged. There was also no change in the proportion which tax revenues made up of government current revenue. There were important changes in the composition of tax: taxes on domestic goods and services rose, as a proportion of total revenue, from 36.0 per cent in 1981-82 to 47.0 in 1991-92, whereas the respective figures for taxes on international trade and transactions were 36.0 and 26.8. Such changes, however, were part of Sri Lanka's macroeconomic and trade strategies and has little or nothing to do with the armed conflict. It does not appear that the war has been financed from increased taxation revenues. Nor does it appear that increased domestic debt has been important source: Its size, as a proportion of total expenditure plus lending minus repayments, changed hardly at all between 1981-82 and 1990-91. Indeed, total government revenue as a proportion of GAP remained constant over the period at around 20 per cent. It does not appear that increased revenues from domestic sources have been important in financing the war.

Diverted revenue

There has been considerable literature (e.g. Harris et al 1988; He's & Mullah 1988; Apostolakis 1992; Frederiksen and loony 1994) examining whether military expenditure increases in developing countries are financed by cutting other government expenditure categories. In summary, the studies have not been able to find conclusive evidence on the matter. Whilst it is clear that an increase in any one government expenditure category as a proportion of the total must be at the expense of some other category, it does not seem that military expenditure has any special capacity to win resources from other expenditure categories in developing countries.

Statistically, trade-offs may be identified via Pearson correlation coefficients (r). A negative and significant r value suggests the presence of trade-off. Table 7 summarizes r values between defence and the other five GEE categories between 1981 and 1992. The residual 'other expenditures' category consists very largely of interest payments. Leaving aside the apparent positive trade-off between defence and social security and welfare, which is difficult to explain⁵, there do appear to be trade-offs between Defence and Housing/community amenities (a small category, expenditure-wise) and economic affairs and services. Comparison of columns 1 and 2 in Table 7 suggests that the increase in Defence has been matched by reductions in the Economic Affairs and Services category. This category includes fuel and energy; agriculture, forestry, fishing

⁵ Such paradoxical results are not uncommon in the trade-off studies. For example, Harris et al (1988) found significant positive relationships between Sri Lanka's education and health on the one hand, and defence expenditure on the other between 1967 and 1982.

and hunting, mining, manufacturing and construction; and transport and communication. Table 8 shows that between 1981-82 and 1991-92 there was a dramatic reduction in resources devoted to agriculture, both as a proportion of the Economic Affairs and Services category and in real values, and a dramatic increase in both these respects for transport and communication. Again, such changes do not appear to be related to the conflict, although it could be surmised that the increased expenditure on transport and communications had at least some military motivation. In summary, there is some evidence to support the idea that government expenditure has been diverted from economic affairs and services to defence.⁶

A second aspect of trade-offs concerns that between current and capital expenditures. In the face of financial stringency or other needs, governments may find it easier to defer capital projects (see footnote 4) than to cut current expenditures, given the immediate implications of the latter for services to the public and employment. This indeed occurred in Sri Lanka between 1980 and 1992 (see Table 9), although there is unfortunately no breakdown of capital and current expenditures by CGE category. The ratio of current to capital expenditures (column 3) rose dramatically, from a position of rough equality before the conflict to over three in the early 1990s. Perhaps more importantly, column 4 indicates that in real terms, capital expenditure fell significantly (i.e. by 39.5 per cent between 1980/82 and 1990-91, whereas current expenditure rose by 81.3 per cent. In fact, the increase in military expenditure in real terms in 1990-91 compared with 1980-82 (see Table 3, column 6), represents about half of the decrease in capital expenditures over the same period (Table 9, column 4). An alternative indicator of the reduction in capital expenditure is the ratio of Gross Domestic Investment to GDP, which fell from 30.5 per cent in 1980/82 to 22.3 per cent 1990/91; the respective averages for the other four South Asian countries were 19.1 and 18.4 per cent (World Tables 1993, Table 13). This reduction in capital expenditures will have negative consequences for Sri Lanka's productive capacity, and must be considered as a major cost of the conflict.

We have seen that there is no apparent trade-off between military and health expenditures. Nonetheless, an examination of current health expenditures is instructive. It is widely believed that Sri Lanka's public social expenditures are high and its 'social' performance impressive. A perusal of World Development Report data (1993, Appendix A) indicates that compared with other Asian Countries (weighted for population and excluding China and India), Sri Lankan health indicators are generally much higher than average. This is not the case, however, for public health expenditure.

The above World Development Report (1993, pp.8ff) has estimated the cost of a limited

⁶ A more sophisticated multiple regression approach, using defence expenditure as a proportion of GDP and rate of growth of GDP as independent variables for the period 1981-90, did not result in any significant coefficients.

package of public health measures and essential clinical interventions. The former includes immunizations against six major diseases, school-based health services, information and services for family planning and nutrition, programs to reduce tobacco and alcohol consumption, regulation information and limited public investments to improve the household environment and AIDS prevention programs. The clinical interventions, which are described as the 'minimum essential package', cover pregnancy-related programs, family planning services, tuberculosis control, control of sexually transmitted diseases, control of the common serious illnesses amongst young children and some treatment for minor infection, trauma and pain. Each measure is regarded as highly cost effective in terms of saved DALY (disability-adjusted life years, a measure combining healthy years lost because of premature mortality and those lost as a result of disability). The estimated cost for low income countries in 1990 was US\$4.20 per capital per year for the public health activities and \$7.80 for essential clinical services, and it is estimated that 32 per cent of the current burden of disease could thus be averted.

Compared with this total of \$12, low income governments typically spend about \$6 per person for health. The Sri Lankan figure, based on the 5.4 per cent of CGE allocated to health in 1990, was \$7.20 per capita, less than two thirds than the World Bank minimum. Clearly there is scope for substantial increases in Sri Lankan health expenditures.⁷ It may be that the impressive health indicators are built upon previously higher levels of public expenditure on health and that the consequences of lower allocations will be felt in the future. The World Bank minimum in 1990 could have been achieved by a transfer of \$81.6m. from military expenditure to health. This would have amounted to a 23 per cent reduction of the SIPRI mile figure for 1990 or a 20 per cent reduction in the WHEAT figure.

Increasing exports/reducing imports

Increasing exports and/or reducing imports has the advantage of earning or saving foreign exchange, which can then be used to import desired goods and services, including weapons. It must be remembered, however, that military imports are only part of military expenditure. Developing country governments have limited influence over the level of export earnings in the short run except, possibly, via exchange rate devaluation.⁸ Sri Lanka's balance of payments performance is summarized in Table 10. Whereas exports as a proportion of GNP remained steady over the period imports fell by 11 percentage points, at least partly in response to higher rupee prices of imports due

⁷ It should be noted that government health expenditures increased by 48.6 per cent in real terms between 1980-82 and 1990-91, as well as increasing from 3.7 per cent of CGE in 1981-82 to 4.8 per cent in 1991-92 (see Table 7).

⁸ The rupee devaluated by around 155 per cent against the US dollar between 1980 and 1992.

to devaluation. The key indicator of trade performance, the current account deficit as a proportion of GAP, moved positively, falling by seven percentage points. The balance of trade as a percentage of GAP shows a similar picture. The growth rate of merchandise exports (6.5 per cent per annum in real terms between 1980 and 1992 compared with import growth of 2.5 per cent) does not suggest that the former has been hindered by the conflict. One source of foreign exchange which was severely affected was tourism; from a peak of 407,000 in 1982, tourist arrivals fell to around 180,000 between 1987 and 1989 as a result of political instability in southern and central Sri Lanka (O'Hare and Barrett 1994). For the mid-1980s, official tourist receipts represented a modest 7.2 per cent of total export earnings (from some 250,000 tourist arrivals in 1985), but 'less direct and much more pervasive... considerations such as widespread spending, the economic multiplier effect and employment opportunities' were also affected. Strong recovery in tourism has occurred since 1990.

Foreign aid

Like export earnings, aid has the advantage of being received in foreign currencies. Sri Lanka received considerable aid during the 1980s, at the fairly constant level of around 9 per cent of GNP per annum. An important issue is that of fungibility, which normally means the ability of the aid recipient to circumvent donor intentions and spend some targeted aid on non-targeted programs. We are more interested, however, in the fact that aid augments government financial resources in general i.e. it has an income effect which can be used, in part, for any purpose. The question is how large a part. A study of eight major United States aid recipients between 1972 and 1987 (Khilji and Zampelli 1994) concluded that military aid was very highly fungible, with around 90 per cent channelled to the private sector for consumption or investment purposes. Non-military aid was highly fungible. Without detailed analysis, it is not possible to say much about the fungibility of Sri Lankan aid. It is possible (although this is not the conclusion reached by Khilji and Zampelli) that the additional financial flexibility allowed by foreign aid has allowed governments to spend more on the military than otherwise. If so, this provides a source of revenue for Ball's five mechanisms noted in section 3.

Personal communication with officers of the Central Bank of Sri Lanka suggests that relatively little military expenditure has been financed by aid. Their reasoning is that since total foreign aid is always well below total capital outlays, and is largely earmarked for development projects and commodity loans, there is little leeway to divert foreign aid to defence.

Foreign debt

Public or publicly-guaranteed foreign borrowings may be made from official creditors (e.g. the IMF) or private creditors (usually western commercial banks). Private non-guaranteed debt disbursements (i.e. new debt actually incurred) during the 1980s were very small. Private creditors fell from around a third of disbursements at the start of the decade to about one sixth at the end. In 1990, official creditors provided 85 percent of

new public and publicly guaranteed debt. Sixty per cent of this came from multilateral sources and 40 per cent from bilateral; virtually all was borrowed on concessional terms. What matters for our purposes is not the total level of debt owed by the country, but the annual disbursements of new debt and the debt service obligations. These are summarized in Table 11 and three points of particular interest emerge. First, an amount averaging the equivalent of 79 per cent of disbursements went to meet debt service obligations on previous debt and there was a tendency for this proportion to increase over the decade. Second, military expenditure was the equivalent, on average, of 7.2 per cent of new debt incurred in 1980-82, although the proportion rose to 36.3 per cent in 1990.⁹ Third, debt service and military expenditure may be added together as a proportion of CGE (column 5, Table 11 and column 4 of Table 4) to derive an estimate of 'unproductive' expenditures. For 1980-82, the proportion averaged 9.4 per cent and rose to 25.0 per cent in 1990-91. Sen's (1990, p.214) figures for 12 developing countries finds a mean figure of around 50 per cent. Taken as a whole, the foregoing data do not suggest that the armed conflict has been financed to any extent by greater foreign indebtedness.

6. Conclusions

This paper has investigated various possible sources from which the six fold increase in Sri Lanka's military expenditure between 1981 and 1991 has been financed. Of the sources listed in Table 1, two aspects of diverted revenue appear to be the main 'sources' of greater military expenditure. There does seem to have been a diversion of financial resources from Economic Affairs and Services (and especially from the agricultural sub-category) to the military, and capital expenditures have fallen significantly over the decade. It should be noted, however, the increased military expenditures were equivalent to about half of the fall in capital expenditures.

The opening paragraph of this article outlines some of the more obvious costs of trying to deal with conflicts by military means. This paper has pointed to another important cost: given that the Sri Lankan armed conflict is being financed largely by diverting government expenditures from productive activities, and in particular capital expenditures, to the war effort, there will be a reduction in future economic growth. Some crude arithmetic based on the well known Harrod-Domar growth equation will illustrate this point. The equation is $g = s/k$, where g = the growth rate of GAP, s = the savings rate (domestic savings as a proportion of GAP) and k equals the capital: output ratio (the number of units of capital required to produce one unit of output). The savings rate is what is left from GAP after government consumption and private consumption (which together make up total consumption) has occurred. In fact, total consumption fell from 87.4 per cent of GAP, 1980-82, to 85.6 per cent in 1990-92. Assuming k was constant at 3.0, GAP would have grown at 4.2 per cent 1980-82 (i.e.

⁹ Calculated by comparing column 5 of Table 3, converted to current US dollars, with column 1 in Table 11.

100-87.4 + 3.0) and 4.8 per cent, 1990-92 (100-85.6 + 3.0). Within total consumption, government consumption (which by definition includes capital expenditures in the defence category) rose from 7.7 per cent (1980-82) to 9.3 per cent (1990-92) and private consumption fell from 79.7 per cent to 76.3 per cent. Had government consumption been at its 1980-82 proportion in 1990-92, and private consumption remained at 76.3 per cent, the rate of growth would have been 5.3 per cent (100-84.0 + 3) in 1990-92 rather than 4.8 per cent. Given that much of the increase in government consumption expenditure has been on defence, this rough calculation suggests that its impact on growth of GAP may be of the order of 0.5 of a percentage point (around 10 per cent less) per annum. This amounts a total loss of production, in 1992 prices, of 369,000 million rupees over the period 1983-92 inclusive. To place this figure in perspective, the GAP in 1992 was around 420,000 million rupees.

After completing this article, I discovered two highly relevant articles by Grobar (1992) and Grobar and Gnanaselvam (1992). The first of these presents a model in which Sri Lanka's military expenditure increase (446 per cent, 1982-88, in rupees) is compared with changes in the economic aggregates against which the increase had to be balanced. The results were as follows, with the bracketed figures being the percentage change in real terms, 1982-88: private savings (8.0), investment (-0.7), exports (18.3), tax revenues (44.0) and non-military government expenditures (-8.7). Grobar suggests that these results 'indicate that the increase in military spending was accompanied by a decline in real investment and real non-military spending' and that 'higher military spending has crowded out investment and investment-related expenditures' (1992, p. 145). This is consistent with my conclusions, reached by an alternative route.

Grobar and Gnanaselvam (1992) assess the potential economic growth lost due to the war, using an excess demand model of investment and a Harrod-Domar growth model. They conclude, first, that an increase of one percentage point in the m/GDP ratio will reduce the investment/GAP ratio by over four percentage points. Second, using a capital-output ratio of 2.5, they estimate the value of output lost due to war-induced lower investment to be 1.5 billion 1988 US dollars between 1983 and 1988, equivalent to 22 per cent of Sri Lanka's GAP in 1988. Assuming the war continued until 1995, the cost would be 11.6 billion 1988 US dollars. Whilst these figures are not directly comparable with my estimates above, the results are again consistent.

Two final points can be made. First, the costs in terms of foregone output are only a part of the total costs of the war: production will have been adversely affected for reasons other than lower investment, and there is the range of costs listed in the first paragraph of this article to be considered. Second, it is also worth considering the cost effectiveness of the attempts to impose a military solution on the Sri Lankan conflict. frankly, the conflict cannot be resolved by military means and the best the military can hope for is to contain the Tamil Tigers and restrict their activities. Non-military approaches have a far greater chance of success and are far less costly in all the aspects mentioned in this paper.

Table 1. Principal means of financing armed conflicts

Domestic sources

Increased revenue

Taxation

Borrowing from the public (e.g. sale of government bonds)

Diverted revenue

Diversion of government expenditures towards the war effort

Foreign sources

Increased revenue

Exports

Foreign aid

Borrowing (from foreign commercial banks)

Decreased expenditure

Non-military imports

Other sources

Payment of armed forces in kind (e.g. looting rights)

Printing banknotes

Table 2. War related deaths in Asia, 1945-92

Country	Years	Conflict	Civilian	Military	Total
Afghanistan	1978-79	USSR intervenes in civil war	1,000,000	500,000	1,500,000
Bangladesh	1971	West Pakistan Military, famine and massacres; India invades	500,000	500,000	1,000,000
Cambodia	1970-75	North Vietnam and United States intervene in civil war	78,000	78,000	156,000
	1975-78	Pol Pot famine and massacre	750,000	250,000	1,000,000
	1978-89	Vietnam vs. Cambodia	14,000	51,000	65,000
China	1946-50	Communists vs. Kuomintang	500,000	500,000	1,000,000
	1950-51	Government executes landlords	1,000,000	-	1,000,000
	1956-59	Tibetan revolt	60,000	40,000	100,000
	1967-68	Cultural revolution	45,000	50,000	500,000
India	1946-48	Muslim vs. Hindu	800,000	-	800,000

Pakistan	1965	Kashmir, India vs. Pakistan	13,000	7,000	20,000
Indonesia	1958-60	Dissident military Vs. Govt.	-	-	30,000
	1965-66	Abortive coup	500,000	-	500,000
	1975-92	East Timor: famine & massacre	100,000	50,000	150,000
Korea	1950-53	Korean war	150,000	150,000	300,000
Laos	1960-73	Pathet Lao vs. govt.	18,000	12,000	30,000
Philippines	1972-92	Muslims vs. govt.	20,000	15,000	35,000
	1972-92	Communist s vs. govt	20,000	20,000	40,000
Sri Lanka	1983-92	Tamil separatists vs govt.	18,000	14,000	32,000
Taiwan	1947	Civilians vs. govt.	20,000	-	20,000
Vietnam	1945-54	War of Independen ce vs. France	300,000	300,000	600,000
	1960-65	Civil war	200,000	100,000	300,000
	1965-75	US/Sth Vietnam vs. Nth	1,000,000	1,050,000	2,058,000
	1979	China vs. Vietnam	9,000	26,000	35,000

Source: Sivard 1993.

Notes: - means not available.

Table 3. Military Expenditure Data, 1980-92

Year	WHEAT	WHEAT	SIPRI	SIPRI	GFS	GFS
1980	-	-	-	971	458	869
1981	50	75	65	1117	479	752
1982	56	78	63	1653	486	687
1983	72	97	82	2194	979	119
1984	82	106	93	5140	1275	1282
1985	167	208	214	7926	4614	4614
1986	153	186	306	10103	4351	4105
1987	201	237	362	9439	6001	5246
1988	322	365	297	8435	4732	3765
1989	323	351	238	15315	4573	3278
1990	398	413	355	17323	6736	4014
1991	432	432	357	10317	5526	
1992						10148

Sources: WMEAT, SIPRI, GFS (various issues)

Note: 1 Using the GFS GDP deflator (1985 = 100)

Table 4 Military expenditure as a proportion and CGE

Year	Military expenditure as a proportion of:			Defence/military expenditure as a proportion of CGE	
	GDP(SIPRI)	GNP(WMEAT)	GNP(GFS)	GFS	WMEAT
1980	1.5	0.7	1.7		
1981	1.2	1.3	0.6	1.9	3.8
1982	1.1	1.2	0.5	1.4	3.7
1983	1.4	1.5	0.8	2.6	4.5
1984	1.4	1.6	0.8	2.9	4.9
1985	3.2	2.9	2.8	8.5	8.4
1986	4.4	2.4	2.4	7.6	7.4
1987	5.1	3.1	3.1	9.6	9.4
1988	4.3	4.6	2.1	6.9	13.3
1989	3.3	4.3	1.8	5.9	13.2
1990	4.8	4.8	2.1	7.4	15.3
1991	4.8	2.7	9.4	15.0	
1992					8.5

Table 5 Imports of major conventional weapons, by value and source (US\$m.)

Country	SIPRI		WMEAT2 1987-91
	1987-91	1988-92	
United States	12	0	10
China	158	96	70
United Kingdom	0	5	
Czechoslovakia	0	8	
Italy	3	1	
Others	101	54	60
Total	274	164	140

Sources: SIPRI(1992; 1993) and WMEAT (1991-92)

Notes: 1 In constant (1990) US dollars
2 In current US dollars.

Table 6 Transfer of major armaments to Sri Lanka, 1980-93

Year of delivery	Number and type of armament	Country of origin	Comments
1980	2 Shangai-2C1 fast gunboats	China	Gift
1981	Nil		
1982	Not available		
1983	2 Model 212 helicopters	Singapore	
(1983)	4 Model 206B helicopter	USA	
(1984)	2 Model 206B helicopters	Singapore	
1985	6 SF-260TP training aircraft	Italy	
	6 Model 212 helicopters	USA	
	1 Super King Air helicopter	USA	
(1985)	2 Tupe 30M landing craft	Singapore	
	6 Samil-100 armoured personnel carriers	South Africa	
1986	2 Y-12 transport aircraft	China	
	2 Type 33M landing craft	Singapore	
	2 HS 748-2 transport aircraft	UK	
	4 Model 212 helicopters	USA	
1987	8 Dvora class fast attack craft	Israel	In addition to 6 delivered earlier.
	10 Y-12 transport aircraft	China	
	2 SF-260TP training aircraft	Italy	Replacing losses
	(6) SF-260TP training aircraft		Second 1986 order
	3 Model 212 helicopters	USA	
1988	() Y-12 transport aircraft	China	Unspecified number ordered in addition to the 10 delivered 1986-87.
	6 Dvora class fast attack craft	Israel	In addition to 6 delivered earlier.
	6 SF-260TP training aircraft	Italy	In addition to 6 in service.
	(50) Buffalo armoured personnel carriers	South Africa	
1989	2 Y-8 transport aircraft		
(1989)	9 BAC-167 Strikemaster	UK	Refurbished ex-
Kuwait	trainer/counter-insurgency aircraft		Air Force; total cost US \$11m.

(1990)	2 Dvora class fast attack craft	Israel	Ordered 1987
1991	4 F-7 fighter aircraft	China	
	2 FT-5 training aircraft	China	
	3 Y-12 transport aircraft	China	
	(18) Type 59/1 130mm towed gun	China	
	3 Shanghai class patrol boat	China	
1992	4 LA-58A Pucara close support aircraft	Argentina	Ex-Argentine
airforce.	(25) T-55 battle tanks	Czechoslovakia	
	2HS-748-2 transport aircraft	UK	In addition to 2 delivered earlier.
1993	3 Mi-17 Hip H helicopters	Russia	

Source: Derived from SIPRI Yearbooks, 1981-1993. Note:()=uncertain or SIPRI estimate.

Table 7 Trade-offs between CGE categories, 1981-92

	Proportion of CGE		Pearson Correlation coefficient with defence, 1981-92
	1981-82	1991-92	
Defence	1.6	17.1	
Social security and welfare	11.4	5.9	0.63*
Education	8.5	9.2	0.37
Health	3.7	4.8	0.20
Housing and community amenities	4.0	1.4	-0.57*
Economic affairs and services	40.6	24.3	-0.61*
Other expenditures	30.2	27.3	

Source: Derived from GFS (various issues)

* significant at the 5 per cent level

Table 8 Expenditure within Economic Affairs and Services, 1981-92

	Proportion of total(%)		Change in real expenditure 1981-91, in 1985 prices (%)
	1981-82	1991-92	
Fuel and energy	8.1	10.7	-19
Agriculture, forestry, fishing and hunting	69.6	28.1	-68
Minerals and mineral resources, manufacturing and construction	6.2	1.8	-74
Transportation and communication	16.5	45.5	230

Source: Derived from GFS (various issues)

Table 9. Government Current and Capital Expenditures, 1980-92

Year	Current expenditure* expenditure** (millions or rupees)	Capital expenditure* (millions of rupees)	Ratio of current toCapital capital expenditure(Millions of rupees)
1980	12319	12123	1.02
1981	14649	11252	1.30
1982	18341	15427	1.20
1983	22022	15863	1.39
1984	24631	19915	1.24
1985	32644	21530	1.51
1986	33966	23236	1.46
1987	39560	22816	1.73
1988	46132	22878	2.01
1989	56884	20750	2.74
1990	71771	19161	3.75
1991	83756	25968	3.23
1992	84327	34475	2.45

Source: GFS (various issues)

* Current rupees

**In constant 1985 prices.

Table 10 Balance of payments indicators, 1980-92

	1980-82	1990-91
Export of goods and services/GNP (%)	35.7	34.4
Imports of goods and services/GNP (%)	52.5	41.1
Current account deficit/GDP (%)	12.4	5.2**
Balance of trade*/GNP (%)	16.2	5.6
Ratio of international reserves to imports of goods and services (months)	1.8	2.0
Terms of trade (1987 = 100)	98.1	87.8

Sources: World Bank, World Debt Tables, World Tables; IMF Balance of Payments Statistics Yearbook (various issues).

Notes: * Merchandise imports and exports
 ** 1990-92

Table 11 Foreign debt indicators, 1980-91

	Disbursements of public and publicly-guaranteed debt* (US\$m.)	Debt service (US\$m.)	Debt service as a proportion of:		
			Exports	GNP	CGE
1980	269	179	12.0	4.5	10.7
1981	388	-	13.2	-	-
1982	471	245	14.9	-	15.1
1983	372	265	15.6	5.2	16.4
1984	427	274	13.1	4.7	15.6
1985	396	320	16.5	5.4	16.0
1986	495	399	20.9	6.2	19.5
1987	392	497	23.2	7.4	23.4
1988	401	487	21.7	7.0	22.4
1989	436	422	18.6	6.1	19.6
1990	464	388	13.9	4.8	17.1
1991	-	431	14.1	4.8	16.2

Source: World Bank, World Debt Tables (various issues)

Notes: * Current prices, \$US millions.

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Book Review

Decentralisation and The Accommodation of Ethnic Diversity by Yash Ghai, Colombo: International Centre for Ethnic Studies, 1995, pp. 62

The United National Party obtained a clear majority and remains in office though Sir John Kotalawala is now Prime Minister. Since it is supported not only by the majority of the Sinhalese but also by the majority of the Tamils and the Muslims, the communal problem has virtually disappeared. The Opposition consists of small groups, three of them Communists. Ceylon has thus continued as an independent country the remarkable stability which it enjoyed as a colony. (Sir Ivor Jennings, *The British Commonwealth of Nations*, London: Hutchinson, 1956, p. 83)

Those of us who helped to frame the constitutional and electoral laws [of Ceylon] did not fully appreciate the strength of communalism among the illiterate and semi-literate electorate. We did provide for something like proportional representation of minorities, but we did not provide them with sufficient protection against communal legislation and ambitious politicians made full use of their ability to appeal to the communal sentiments of the majority. (Sir Ivor Jennings, *Democracy in Africa*, Cambridge University Press, 1963, p. 66)

Sir Ivor Jennings, whom I quote as a preface to this review, was Vice-Chancellor of the University of Ceylon from 1941 till 1954. In 1954 he left Ceylon to become Master of Trinity Hall in the University of Cambridge. When he was Vice-Chancellor of the University of Ceylon, Jennings was virtually honorary constitutional adviser from 1943 till independence in 1948 to Mr D S Senanayake, the island's first Prime Minister. It was Jennings who drafted many of the provisions of the Constitution of Ceylon contained in the Ceylon (Constitution) Order in Council, 1946. (Preface to Jennings' *The Constitution of Ceylon*, Oxford University Press, 1949)

The contrast between the views expressed in the true quotations is very striking. In the first quotation, Jennings expresses the view that the communal problem has virtually disappeared. In the second quotation, he frankly admits that he had misunderstood the strength of communalism among the illiterate and semi-literate electorate. The constitution which he had helped to draft had not provided sufficient protection against communal legislation.

So this is the considered opinion of a constitutional authority with a deep knowledge and long experience of the conditions prevailing in the island. I have prefaced my review of Professor Ghai's book with the above quotations because they are directly relevant to its theme -decentralization and the accommodation of ethnic diversity.

In a BBC broadcast in 1961 published in *The Listener* of February 23, 1961 under the title *How to Transfer Authority*, Jennings said:

... [W]e eventually produced a Draft Constitution which was approved with some modifications, by the Ceylonese Ministers and the British Government. It has not been a complete success; and if I knew then as much about the problems of Ceylon as I do now some of the provisions would have been different... What I am sure is that all the problems which can reasonably be foreseen ought to be solved - in so far as they can be solved - before the transfer of authority takes place. In other words, a detailed and permanent Constitution ought to be carefully worked out beforehand. ... Mr. D. S. Senanayake .. did in fact work hard to get a united people behind him on a scheme which was a reasonable compromise of competing interests. The transfer of authority in 1948 was smooth and peaceful and the Constitution worked well until he died in 1952 and for a few years afterwards. (p. 338)

In this same broadcast, Jennings refers to the Indian experience:

The Indian National Congress has had an experienced and broad-minded leader in Mr. Nehru. He has been able to keep down sectional loyalties while at the same time recognizing cultural differences. He has not sought to integrate the different communities: in the condition of India that would be impossible. He has not even tried to produce a partnership which is the word generally used in Africa. He has sought, with considerable success to enable every person, without distinction of race, caste or creed, to take as large a part in the process of government as his abilities and interests allowed. I will not say that the government of India has been a model; but certainly it is the best example so far provided. ... We must have a constitution which gives full protection to the various interests in the country, however diverse they may be, so as to ensure that they can play a full part in the life of the country... We must have broad-minded and patriotic leaders who remember that, though they are mortal, the nation is immortal. They have to establish such precedents and to create such conditions that their work can go on long after they are dead. Indeed, they have to remember that their successors may have entirely different views on many of the problems that arise. In constitutional terms they have to ask themselves whether the machinery of government will work just as well when their political opponents are in office as it does now, while they are in office... we must have a good educational system which gives the young men and women a sense of mission, so that they will spurn the pettiness of political rivalry and keep in view the larger patriotism. (p. 338)

It is worth quoting Jennings at length in this review as most readers may not have ready access to an issue of *The Listener* published as long ago as 1963. From these quotations one sees readily the kind of problem facing countries like India and Sri Lanka and why the makers of the Constitution of Sri Lanka at the time of independence

had not seen the need for devising a different type of constitution. One also observes the statesmanship displayed by Jawaharlal Nehru in facing problems very similar to those experienced in our own country.

The author of the monograph under review - Prof. Yash Ghai - uses the term 'decentralisation' in a broad sense to include both federalism and devolution. It may be pointed out that devolution in its more usual sense is the handing down from a superior authority to an inferior; the transfer to a subordinate elected body on a geographical basis of functions exercised by a country's legislature or ministers. Federal government involves a division of the functions of government between an independent common authority for the whole country and independent authorities for the constituent parts of the country. The constitution sets out the powers of the centre and the provinces. The supremacy of the constitution is an essential feature of a federal system. The powers of government in a federal constitution are divided between the government for the whole country and the governments for parts of the country in such a way that each government is independent of control by the other. The law-making bodies of the whole country and of the parts enjoy co-ordinate status.

However, the author has chosen to give the term 'decentralisation' a wider meaning in this paper.

He identifies two kinds of decentralisation. The first is a territorial arrangement -spatial decentralisation. The second, he describes as corporate decentralisation. Corporate decentralisation may take many forms ranging from a group's custody of personal laws of its members to the preservation of institutions of internal governance. Both kinds of decentralisation can exist together but sometimes when territorial decentralisation is not possible or desirable corporate decentralisation is adopted as a solution.

In a very interesting and perceptive paper published in the *Political Quarterly* (Vol 66, No. 1, pp. 84 -97), Vernon Bogdanor, Reader in Government in the University of Oxford, refers to a highly original idea known as 'personal federalism'. Personal federalism has been adopted in Estonia where cultural councils have been created. Ghai's corporate decentralisation is very similar to, if not identical with Bogdanor's 'personal federalism'. In his paper Bogdanor examines the problems of democracy in plural societies. The Westminster model can only work in homogeneous societies. He suggests various means of power-sharing which will enable a democratic government to operate. The present reviewer would urge his readers to refer to Bogdanor's paper. The theme is closely related to Ghai's study of decentralisation and the accommodation of ethnic diversity. Ghai has a section on federations in communist states -the USSR, Yugoslavia and Czechoslovakia - now defunct. The role of the party in holding in check the fundamental incongruity between centralized party rule and the logic of ethnic federalism is stressed. In those countries federation was no longer a solution, but separatism.

Yash Ghai devotes a section of his paper to federations in the third world (pp. 17 -32). He points out that the proposals for federation differed from the experience of older federations in an important respect. In the older federations, previously independent sovereignties came together. In the third world previously highly centralized and bureaucratic states were decentralized, (disaggregation). He discusses

the federal arrangements in India, Nigeria and Malaysia (pp. 22 - 30). Section iv of his paper is on corporate decentralisation which may be an alternative to spatial decentralisation though it is possible sometimes to adopt both systems together. He refers to the cultural councils of Belgium (p. 40) and the arrangements made in Fiji (p. 41). He points out that spatial decentralisation is possible only with physical concentrations of groups. When this factor does not exist, corporate decentralisation may be possible but is inherently harder to work (p. 51).

On page 54, the author draws a distinction between federations by aggregation and federation by dis aggregation in relation to secession. Federations by disaggregation result from diffusing a unitary state. The author observes that so-called instances of secession or attempted secession from a federation are found on closer examination not to be a logical result of federalism. For example, Bangladesh broke away from Pakistan because of the refusal to treat East Pakistan as an equal partner, despite its larger population. Urdu was imposed on a Bengali-speaking people and the broadcast of the songs by Tagore had been banned. Mujibur Rahman's proposals for a genuine federation had been rejected (p. 54). The break-up of the USSR and Yugoslavia was also the result of the failure to create a genuine federal system. The Communist Party had to hold the two states together preventing an organic unity (p. 55).

In the last paragraph of his paper the author refers to Papua New Guinea where parts of Bougainville wanted to secede. He concludes that the attempts at secession did not result from decentralisation. 'Rather the rebels couch their claims in the language of self-determination, ignoring the significant autonomy that the province enjoys... As in so many modern instances, the villain of the piece is not decentralization, but self-determination.' P. 56) Professor Ghai's monograph is most instructive and stimulating. It is of special significance in a plural society like that of modern Sri Lanka. It is a valuable contribution to the study of decentralisation and the accommodation of ethnic diversity.

Krishnaraja Selvaratnam

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NOTES TO CONTRIBUTORS

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- Tonak, E Ahmet. 1987. "The U. S. Welfare State and the Working Class, 1952-1980" *Review of Radical Political Economics*. Vol. 19.No. 1. pp 47-72

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