LIBERALISATION AND POLITICAL DECAY: SRI LANKA'S JOURNEY FROM WELFARE STATE TO A BRUTALISED SOCIETY

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Only two decades ago, there was consensus in the international development literature that Sri Lanka stood out a paragon of social development and pluralist democracy. Today, its economy is in trouble. It lurches from crisis to crisis; the war continues, there is widespread disillusionment with political leadership (of whatever party), and few can ever have lasting faith in the intentions of government. There is a general feeling that the rapid growth and prosperity that should have followed economic reform has been systematically undermined by a lethal combination of bad governance and effects of the ethnic conflict— in a sense, that the country got the economics right but fell short on the politics. Social and political developments are treated as exogenous variables in the reform equation, unrelated to the monumental changes that have taken place in economic policy.

It is our contention that this view is wrong, and that it is a serious misrepresentation of the Sri Lankan problem. We will argue that, regardless of what the World Bank and the IMF may have us believe, in practice, no liberalisation package is just economic. It invariably combines both economic and political elements. It is country-specific, embodying and shaped by institutions and political culture, and it is the politico-economic character of the particular package that determines the post-reform trajectory. We believe, therefore, that what has been happening in Sri Lanka has to be seen as the outcome of inter-linked economic and political policies, implemented in a distinct but dynamically-evolving historical-institutional setting. Liberalisation has to be interpreted, not just as a turning point in economic policy, but as part of a much broader picture, giving momentum to the profound and disturbing transformation that has occurred in the social and political life of the country.

At the same time, however, it is important to recognise that pre-reform Sri Lanka was never quite the haven of peace, democracy and equality that has been depicted. The roots of post-reform problems are to be found in what happened earlier—in pre-existing, historically-evolved socio-political and institutional structures. There have been clear continuities. It is essential, therefore, to look at the 1977 policy changes in a wider context in order to be able to appreciate how the past shaped the future. When the UNP came to power in 1977, the Sri Lankan economy had reached an impasse and fundamental changes in policy were clearly imperative. Economic stagnation was generating socio-political instability, democratic institutions were being undermined by authoritarian leanings of the government, and a proliferation of government regulations and extensive state intervention in all areas of economic life stimulated rent-seeking and corruption.

So many of these problems are not new. When it came, specific features of the liberalisation programme (and the manner of its implementation) reflected and interacted with pre-reform structures of socio-political relations and networks of patronage. In particular, they fed (and heightened) pre-existing ethnic and class tensions. The liberalisation process neither reduced nor eliminated rent extraction: on the contrary, it expanded the opportunities that existed on a quite unprecedented scale. Politicians, state bureaucrats and a new group, the military and police hierarchy, found a fertile ground for large-scale self-enrichment through the control of state power. However, since these opportunities were threatened by existing political freedoms, potential public scrutiny, and normal democratic processes, incentives to undermine legal and political freedoms and institutions grew. Once locked into this path, those in control of the state ensured that the economic reforms were designed and implemented in such a way that the benefits continued. A mutually reinforcing process of economic 'reforms' and socio-political decay was thus set in motion.

But Sri Lanka is not unique in this. It is noteworthy that, for all its distinctive features, there are remarkable similarities between Sri Lankan experience and that of many other countries that have implemented liberalisation policy reforms over the course of the last decade. The experience of economic crisis, social and ethnic conflict and political disintegration in many Central and Eastern European countries echoes a similar story, and the relevance to other South Asian countries is obvious. This provides analysis with an important sense of perspective.

The structure of the argument is the following. We begin by presenting our view that the point of entry is critical in understanding what is happening—that you have to consider the actual Sri Lankan policy package (that was both economic and political), not just an economic package (along the lines of neo-liberal orthodoxy). We then try to conceptualise likely links between the economics and politics based on recent theoretical developments and the experiences of other countries. After that, the discussion reverts back to Sri Lanka, re-appraising what happened and exploring in more detail the inter-linkages between liberalisation and socio-political decay. The discussion is then rounded off with some brief concluding remarks.[1]

The Sri Lankan policy package

Looking back at the literature, Sri Lankan liberalisation policy in the late 1970s can be seen to have been defined very narrowly. True, it separated trade and exchange rate liberalisation (true-blue economic policy) from the public sector investment programme (the Mahaweli in particular). The latter was seen as a long-term investment in basic infrastructure (not a liberalisation measure) and, despite its undoubted and very profound effects on the national economy, as an 'extra-mural' activity. The economic reform programme was carefully and systematically circumscribed as a well-defined economic policy package that would produce long-term growth and prosperity. Parallel evidence of a growing centralisation of political power, constitutional changes and mounting repression of opposition and dissent (if they were mentioned at all) were waived away as exogenous and as quite separate developments.

But does all this make sense? We believe it was a serious misrepresentation of what was happening because in practice the policy package was not confined to economic reforms (let alone neo-liberal measures) and because a narrow, purely 'economic' analysis of this kind distracts attention from any meaningful consideration of political alternatives. The Sri Lankan policy package has to be understood as a whole. It has to be viewed not just as a jumble of separate and relatively independent policy initiatives, but as a UNP programme—driven by economic, political and ideological imperatives that aimed to revamp the country's economic and political landscape. Though these initiatives developed and evolved in response to economic and political opportunities as and when they arose, separate elements of the package reflected an underlying unity of purpose. The overall objective was to reorient the economy—to alter patterns of resource allocation and benefits, to ensure and entrench the party's political domination and settle many 'old debts' in the process. All this is equally true of the Premadasa regime and that of the Peoples' Alliance. We will look at each in turn.

The Jayewardene Government

The strategy and policy package of the Jayewardene government clearly contained dimensions that were both economic and political. There were three main strands to its economic policy (trade and exchange rate reforms, the public sector investment programme (PSIP) and cuts in food subsidies) and there was a series of clearly related and less obviously related political elements (the latter concerned more with distributional issues, political control and the centralisation of power). None can be fully understood separately or from a purely economic or a solely political perspective.

For example, from the start of trade and macroeconomic policy reforms in the late 1970s, implementation of the reform agenda was essentially discriminatory—albeit also complex because ethnic and class dimensions were interwoven. The criteria on which trade liberalisation was shaped were in practice highly political. As Cuthbertson and Athukorala (1990:408) pointed out "...the greatest policy failure was not to apply a policy of gradual (even very gradual) overall reductions to this new set of tariff-only barriers. Instead, the government fine-tuned the tariffs on a discriminatory basis. It would have been much better to have taken further across-the-board measures. This was apparently judged to be politically impossible". They maintained that "much of the fine tuning...was aimed at saving the monopoly position of certain public corporations, for example, tires, chemicals, paper, and pharmaceuticals" (p. 364). Imports of grapes, chillies and onions grown in the Jaffna peninsula by Tamil farmers were liberalised, while paddy and potatoes grown predominantly by Sinhalese farmers remained protected.[2] Favored state enterprises (that provided 'jobs for the boys') were also kept outside the liberalisation effort, running bloated wage bills and attracting large fiscal transfers.

The PSIP was largely driven by political imperatives and it was equally discriminatory. The Accelerated Mahaweli Development Project (AMDP) in particular was projected by the government as a visible symbol of progress that touched deep-seated nationalist and religious sentiments among the Sinhala-Buddhist community. It had a twofold effect in that the benefits accrued primarily to the Sinhalese and that the new settlement was seen by Tamils as continued encroachment on land that had been traditionally theirs. More generally, the PSIP generated short-term employment and provided sources of patronage. It promised large-scale employment for youth, land for the rural poor and the prospect of lucrative government contracts for the government's business supporters (mitigating some of the adverse impact of liberalisation on import competing industries). As a result, rather perversely, the state sector experienced a significant growth during the early period of the 'liberalisation' programme.

The third element of the economic policy—the changes in welfare expenditure—had no pressing economic rationale. There was no obvious development rationale: no rigorous study had (or has) ever demonstrated that Sri Lanka's poor pre-1977 growth performance was due in any significant measure to its food subsidies, or that protectionist trade policies were a necessary consequence of food subsidies. Nor was there any immediate fiscal rationale: the budget deficit was expanding but, with large inflows of external funds, fiscal austerity could in no sense be said to have been driving policy. The primary motivation for the cuts was ideological and political. Jayawardene (who had made the abortive attempt to cut food subsidies in 1953) had long been an opponent of subsidies. For him, their continuation symbolised the unwarranted political power of the left and the unions. He now saw a political opportunity that had eluded him for a quarter of a century—not just to cut consumer subsidies but, perhaps more importantly, to confront and crush the trade unions. Cutting 'welfare' expenditures thus became a key component of the government agenda. By raising food prices, they also bolstered support within the farming community and the brunt of the burden of subsidy cuts fell on urban workers who had traditionally supported the left.

Once he had acted, it was almost inevitable that the cuts would provoke a confrontation with the unions, and indeed it seems very likely that this was a conscious part of his political strategy.[3] In July 1980, public sector employees (who were strongly unionised) tried to resist cuts in their living standards through strike action, and this was to prove a watershed in the political life of the country. Jayawardene considered trade unions a tool of the political left, and he had been preparing for battle. In 1978, he had threatened public sector employees with dismissal if they participated in a one-day token strike called by the left-wing unions. In 1979, he had passed an Essential Public Service Act that gave sweeping powers to the government to outlaw trade union activities in the state sector (de Silva & Wriggins 1994). And now the government was completely intransigent: it refused to negotiate, ordered workers to return to work, and summarily dismissed thousands who defied the order. Political opposition to these measures was brutally repressed. Troops were called out, strike-breakers from the pro-government trade union—the Jathika Sevaka Sangamaya (JSS)—used strong-arm tactics against strikers. Unions were also banned from the new export processing zones. With the collapse of the 1980 strike, trade union activity that had characterised Sri Lankan political life since the 1930s was muzzled and seriously weakened, closing off what had hitherto been an important avenue of legal protest.

However, this deep-rooted hostility towards the trade unions was only one part of a broader pattern of increasing political centralisation and authoritarianism. It was reflected, for example, in the replacement of the Westminster-style parliamentary system with a new, Gaullist-type constitution led by an executive presidency. It involved minimum accountability to parliament, steady erosion of civil and electoral rights, high-handed treatment of ethnic minorities, a refusal to hold parliamentary elections and the subsequent extension of parliament through a referendum. Moreover, powerful centralised political control and the impression that the government was omnipotent were not just a reflection of the undoubted weakness of the opposition, of Jayawardene's shrewdness and of his political persona (Moore 1990). They were interwoven with the economic policies that were being implemented. He was firmly committed to reversing what, for him, had been fifty wasted years of welfarism and left liberal policies, and committed to reshaping political institutions to ensure that the economic policies he was implementing could not be challenged or derailed. He was determined to build a system of political loyalty and centralised power that would make his vision a reality.

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

Initially, however, corruption did not surface as a major political issue. Rapid growth of the economy produced high expectations and the public was willing to tolerate some degree of corruption as part of the price for success after so many years of shortages and economic stagnation. But, once the initial surge of growth had begun to moderate, dissatisfaction with the regime began to mount. As early as 1982, considerable popular dissatisfaction was already in evidence. There were widespread allegations of vote-rigging in the presidential elections that saw the re-election of Jayawardene. His refusal to hold parliamentary elections (due in mid-1982) and his decision to extend the life of parliament (where the UNP enjoyed a two thirds majority) through a referendum was, as Manor (1984:1) put it, "the most dramatic change in political practice in Sri Lanka since Independence". The referendum itself was marked by contempt for the law, detention of opposition leaders, widespread thuggery and intimidation and considerable vote rigging (Samarakone 1984).

There was, as a result, a growing perception among all layers of the population that normal legal and parliamentary forms of political protest and change were being systematically closed off. And it coincided with an economic slowdown and perceptions of heightening inequality and alienation among important segments of the population. The implementation of the PSIP had a negative impact on the establishment of labour-intensive export-oriented industries that might otherwise have expanded faster in response to liberalisation measures. Selective trade liberalisation and the political patronage associated with PSIP significantly increased the sense of marginalisation among Tamils. Cuts in consumer subsidies and the emergence of a 'new rich' enhanced perceptions among the low-income youth that the development strategy of the government was pro-rich and anti-poor. There were ample grounds for widespread disillusionment.

With old avenues for expressions of dissent and protest shut off, support for extra-parliamentary forms of struggle widened, particularly among Tamil and Sinhalese youth who felt themselves excluded from the 'new economy'. Among Tamil youth—the secessionist movement, the Liberation Tigers of Tamil Eelam (LTTE)—began to gather force. Among the Sinhalese, the JVP was revitalised and gained support, particularly in rural areas. When there were widespread anti-Tamil pogroms in 1983 – allegedly with the complicity of a minister and some sections of the military – the initial response of the government was heavy-handed and unsympathetic, paving the way for a major shift in Tamil attitudes towards separatist movements and an escalation of the conflict.

And as the regime became increasingly mired in a drawn out military conflict in the north and east, the pace of economic reforms slackened as did economic growth. The nature of the emerging regime became more visible. It was deeply unpopular and, according to Moore, it was kept in power by a military-cum-political intelligence apparatus and by arming its cadres (Moore 1990:345) —the latter a trend that was to be perpetuated. The authoritarian character of the regime was increasingly resented, in turn requiring a firmer hand to retain control. Popular dissatisfaction grew in the rest of the country and produced the conditions for the second JVP insurrection that paralysed much economic activity in many parts of the country in the late 1980s.

The Premadasa Presidency

After the elections in 1989, the in-coming president, Premadasa, was faced not only with the political challenge of dealing with the insurrection but with a major economic crisis. His response was firm and effective, establishing a virtual dictatorship and ruthlessly crushing the second JVP uprising. An agreement was negotiated with the IMF, a second wave of liberalisation reforms was implemented and, for the first time, privatisation became a major item on the government's policy agenda. The economy recovered strongly with the re-establishment of political stability. Liberalisation enhanced the incentives for export-oriented production, foreign investment started to flow in, export industries (particularly the textile and garments sector) expanded rapidly, and a general sense of optimism emerged within the business community, both foreign and domestic.

In effect, the Sri Lankan economic and political regime came to resemble that of Suharto in Indonesia. Power and decision-making were centralised, dictatorial practices of the President became increasingly blatant, corruption was institutionalised (and allegedly streamlined within the presidential office), but there was also policy clarity and stability. Business became increasingly confident that there would be no labour problems or other forms of disruption to economic activity. Many (including some left-leaning academics) saw the government as corrupt and dictatorial but efficient and good for economic growth. Sri Lanka seemed to have embraced the authoritarian growth-state model of the then vibrant East Asian 'tiger' economies, and there was considerable speculation that it was at last on the way to emulating the East Asian NICs.

But this was to be a short-lived dream. Such a drastic change could not be imposed on the institutions of Sri Lankan political and social life for long without a major reaction. Despite the economic success, political opposition widened and produced an escalating wave of repression and, after a series of yet-to-be-solved murders of key political opponents of the President, he was himself assassinated in 1993. Elections in 1994 saw the Peoples' Alliance (led by the SLFP) come to power, pledging an end to the war and a negotiated peace with the separatist LTTE, committed to clean, transparent and democratic governance, and advocating pro-poor economic policies. In the light of subsequent events, it is particularly noteworthy that it had also adopted a strong anti-privatisation stance. It did not take long for the new government to do a complete 'volte face.'

The Peoples' Alliance

The PA government – a coalition including remnants of the traditional left parties—was expected to place a break on the liberalisation process, if not indeed to reverse it. Instead, it rapidly committed itself to the reform agenda, working closely with the World Bank and the IMF. Even the few consumer subsidies, introduced in the early days of the government, were subsequently largely withdrawn. In the political sphere, it may even have outdone its predecessor in election-rigging and in political corruption. And it has become clear that the pro-war lobby has been powerful enough to ensure no concessions are made that could lead to negotiations for peace. There has been a seemingly irresistible downward slide on political, economic and social criteria that has led to a chronic and protracted crisis.

But why has a PA government, that raised such euphoric expectations when it came to power, changed its policies so rapidly and so sharply to the extent that it has become virtually indistinguishable from its predecessors in its political conduct? Why has the country reached such an impasse after almost a quarter a century of economic reforms that have won praise from international institutions for "good macroeconomic management and progress in trade liberalization, privatization, and financial sector reform"[4] and that have made Sri Lanka the most open market-oriented economy in South Asia. In the next section, we try to conceptualise this process, drawing on recent theoretical developments and the experience of other countries.

Conceptualisation

Any analysis of the political responses to a liberalisation package has to appreciate that it involves profound distributional changes. Even if it does lead to faster growth and to higher average incomes, the gains will be distributed unequally, often with a significant number of losers, especially in the short-term. Indeed, we have argued elsewhere that it may not just be actual gains or losses that are important, but perceived changes in relative inequality and in possible future opportunities (Dunham & Jayasuriya 2000). The latter we considered to be particularly important in explaining increased social tension. Policy and institutional reforms can have a profound effect on the underlying determinants of asset returns (by revaluing skills and other human capital, revaluing the social capital embodied in ethnic, religious and other networks, and revaluing physical capital) so that the perceived net wealth of the household or of individuals is redefined. Actual or potential distributional changes can then prove a potent source of social and political conflict along already existing (class, ethnic, religious or regional) 'fault lines' in the society. This is particularly likely to occur when reforms fail to generate a large or rapid expansion of the total economic pie.

However, the social impact of policy reforms is by no means confined to these impacts on income, wealth and perceived inequalities. They also generate new opportunities for rent extraction—through discriminatory use of the policy process and through the favoured use of political power and regulatory institutions. We argue below that they can increase the scale of the potential gains from rent-seeking quite dramatically, though the extent to which they can be appropriated obviously depends on specificities of the particular political and social environment.

It is important in this respect to note that the reform agenda itself has undergone significant change. In the late 1970s, emphasis was placed on the implementation of specific pro-market policies—in particular trade liberalisation and complementary changes to the exchange rate regime. The initial reformers were very much innovators: lessons of the Thatcher and Reagan years were yet to come, neo-liberalism and economic reform were new and they were also politically contentious. Unless a government had crushed the opposition (as had been the case in Chile), it could ill-afford to run ahead of its political constituency and it had often to deliver quick and tangible benefits to maintain popular support. But as time went on, and more particularly after the demise of the USSR in 1991, the content of a reform programme changed to mean a fundamental transformation involving a drastic overhaul of property rights and deregulation of the whole economy.[5] By the early 1990s, after the fall of the Soviet Union and the adoption of pro-market policies in China, a visible socialist alternative had effectively ceased to exist. And, with widespread acceptance of the neo-liberal agenda, the political context in which reformers operated became distinctly different. Liberalisation had become mainstream and governments were no longer faced with viable policy alternatives. Willingness to acquiesce and embark on a liberalisation programme secured the blessing of international financial institutions and offered the prospect of possibly significant rewards in terms of large-scale foreign capital inflows and foreign aid. Resistance, in contrast, no longer appeared to offer any tangible benefits. Market liberalisation was increasingly accepted throughout the political spectrum as essential for promoting growth.

It was also seen as significantly undermining conditions under which corruption could flourish. Though they were by no means the only source, literature on rent-seeking behaviour (beginning with Tullock and Kreuger) gave the impression that rent-extraction was firmly rooted in state controls. And it created the assumption that liberalisation and deregulation – when they had eventually been achieved—would lead, almost as a matter of course, to its elimination.[6] In practice, of course, complete liberalisation and deregulation never occur overnight. They are staggered over time. And, since the process normally takes place in fits and starts, theorists might argue that rent-seeking activity cannot be ruled out when market institutions are still imperfect or completely absent.[7] Nevertheless, by-and-large, the assumption of neo-liberal thinking was (and is) that liberalisation (when it has been carried out) would solve the perennial problem of rent-seeking behaviour.

But is that realistic? We would argue that, quite the contrary, a staggered reform programme aimed at a complete transformation of state-dominated economies, can open up (and subsequently entrench) rent-seeking opportunities on an hitherto unprecedented scale. Rolling-back the state may be the ultimate objective, but during the transition period it is the state that controls the pace and sequencing of the liberalisation process, and those who control or who can influence the state can find themselves in a highly privileged and fortuitous position. The state decides which sectors are liberalised (and in what sequence), which activities are privatised, how tendering will be dealt with, what will be the terms of any eventual sale to the private sector, and what it will face in future via competition policy (see Stewart 2000: 248). With privatisation, it is possible for the first time to sell off valuable state assets (most notably public utilities such as telecommunications, energy and transport) as a core component of a government economic policy programme. Arguably, the short-term stock of rents that can be extracted by a few individuals from privatisation far exceed those from nationalisation (even if the latter produced a flow of benefits over a much longer period). And, as many of the buyers are likely to be foreigners, the opportunity for corrupt transfers of funds to safe overseas locations provides an added attraction. The extent to which this actually takes place will obviously vary, being always in part conditioned by the political context, but the potential is nevertheless there.[8]

For the private sector, economic liberalisation means that the potential rewards for investment are also correspondingly larger. Domestic and foreign entrepreneurs are willing to pay more for the opportunities that are offered than in the pre-reform era. Liberalisation of foreign investment is a central part of the reform agenda and, not surprisingly, FDI inflows can increase long before a complete set of policy reforms have been implemented, anticipating higher profitability in the future. Selective application and manipulation of trade and investment liberalisation is thus a powerful weapon that can be used to political and personal advantage. And, as with privatisation, the conduit role of the state (and of its leading figures) does not disappear. Most FDI has to be formally approved, designated sectors can obtain extra assistance, while others can find themselves faced with regulatory barriers (national security, environmental protection, cultural objections etc.). It is not surprising, therefore, that in many countries those in charge of dismantling control regimes and the privatisation of state assets have found new and greater opportunities for nepotism and for lucrative rent extraction.

How much of a problem this poses to the implementation of economic reforms is partly an empirical question and it is a matter of considerable debate. As we have noted, many supporters of liberalisation consider corruption in the course of reform to be a transitory phenomenon—a cost society has to bear until it has an efficient market economy. They believe that liberalisation will "reduce the opportunities for corruption in the long-run" (Tanzi 1997:168). But such a fortuitous outcome is in no sense inevitable. As we have seen, it can also provide additional resources for existing structures of patronage, and create new structures whose interests are in no sense compatible with a liberal economy that eliminates rent extraction. The liberalisation process then becomes 'distorted': it produces outcomes that not only diverge from the ideal assured by its proponents but entrenches a system that ensures smooth and unabated rent extraction. In other words, the liberalisation process becomes 'path-dependent', with outcomes diverging more and more from what may be economically 'efficient'.

The danger then is that, as the stakes get higher, political power is sought for the control it gives over the distribution of a potentially rapidly expanding pot of economic resources (Stewart 2000). Holding on to power becomes a matter of fundamental importance, both because of the largesse and influence it yields and because of the much greater economic and political cost of being marginalised as losers. As a result, incumbents become more willing to subvert political institutions, processes and movements that threaten their grip on power. Public scrutiny and dissent is suppressed, activities of political opponents and their supporters are undermined and democratic freedoms are eroded. Contenders for power often find group cohesion, and the ethnic or class differences that can spark it off, a powerful mobilising force in the competition for resources (Samarasinghe & Coughlan 1991; Stewart 2000.); there is less concern with transparency, and perceptions of inequality and social exclusion begin to mount. When combined with the redefinition of asset values and related changes in wealth and incomes, this can become a recipe for acute social and political conflict, as disgruntled social groups provide bases of political support for those posing as defenders of transparency and a wider 'public' interest. But, then, what determines whether a country proceeds on a 'golden' path of steady growth and development or gets locked into a downward spiraling 'destructive' path? Why did Sri Lanka decay?

Re-interpretation

The nature of the Jayawardene regime's early policy package was described in some detail earlier to show that it was far broader in scope than is often appreciated, and conditioned by history, ideology and institutions. The specific components of the package were such that the outcome was bound to aggravate social and ethnic tensions in a country that already had deep historically-evolved fault lines. As the initial economic stimulus of the PSIP waned, discontent widened but found traditional avenues of protest and political action blocked by a regime that had become assertively and arrogantly authoritarian. The particular combination of massive foreign aid, economic reforms, and large-scale military expenditures provided new and lucrative sources of corruption. Politicians and the bureaucrats administering projects began to benefit significantly, and the payment of unofficial 'commissions' became increasingly the norm as corruption was institutionalised. In the 1980s, when funds to 'lead projects' dried up, the scope for large-scale corruption of this nature was reduced, only to be revived with privatisation in the early 1990s which saw very little transparency (on this see Dunham & Kelegama 1997). And as protest and opposition to the regime spilled over into extra-parliamentary action and was met by repression and by more authoritarianism, the scope for corruption was even further enhanced.

The escalation of military expenditures from the mid-1980s introduced another dimension to the corruption and patronage. It had two principal strands. Large-scale military purchases from abroad provided opportunities for brokerage, yielding significant commissions for military personnel and the politically-favoured civilians who became involved. And, domestically, the expansion of the military and security-related activities presented opportunities in tendering and the state purchase of goods and services The security situation was also one in which there was enormous scope for forms of corruption such as blackmail — exploiting vulnerable figures against whom accusations of having sympathies or contacts with the Tamil Tigers (or indeed just being a security risk) could be relatively easily contrived. The latter was a development made all the more viable by the general erosion of state protection and civil rights.[9]

It is in this context that we can begin to understand the rapid shift in policy by the PA government towards privatisation. Not only did it reverse its stand, it surpassed efforts of the previous regime by fully or partially privatising a range of enterprises including the national airline, telecommunications, plantations and ports. As described in the previous section, privatisation of state assets could provide rents on a scale that far surpassed what could ever be obtained from the import protection of selected sectors. And rent-seeking could be taken still further. Regulatory powers that controlled the competition in a particular market could be used as a source of yet more additional funds — on top of rents extracted in the privatisation exercise itself. Given these powerful incentives, it is unsurprising that the new government not only reneged on an explicit promise not to privatise the telecommunications industry, but shifted its regulatory stance to one that restricted competitive pressures on the newly privatised entity (Jayasuriya & Knight 2001).

Furthermore, the interests of the politicians who were in a position to extract continuing rents from the privatisation exercise coincided with those of others who could extract them from the other major continuing source, the country's civil war. Shared economic incentives converged in shared political interests. And, for both, continued access to political power was essential to maintain these lucrative sources of massive wealth. This created the economic basis for a coalition within the government's ranks (with some outside participants) to stifle any initiative to establish more transparency in government purchases, contracts and other commercial dealings. And this wealth became a major source of finance for the maintenance of patron-client relations that continue to provide the bases of political power and influence throughout the country. The state enterprise sector has shrunk, as have the opportunities for exploiting the state apparatus to dispense employment and other benefits (though they have by no means been eliminated). But the problem has been circumvented to a considerable degree by the massive expansion of ministerial posts and privileges (ballooned by coalition politics) and, more generally, by the now-extensive privileges of all politicians. The process has also been facilitated by World Bank initiatives for the decentralisation of government finances which enables politicians to access substantial funds to buttress their patron-client networks at local level. In combination, these processes have entrenched a system of political corruption that subverts political democracy and judicial independence. They also create incentives for others to establish organisations and forms of activity that can challenge them: teams and individuals excluded from the game by adjustments to the rules seek new games and new rules!

And yet, for all the similarities, there are also several significant differences between a regime that is a weak coalition of groups and a powerful centralised authority—particularly the de facto dictatorship of Premadasa. First, the corruption no longer seems to be centralised. The weakness of central authority has been reflected in a 'democratisation' of corruption and a plurality of centres of influence-peddling. The government, lacking an effective parliamentary majority, depends on minor parties and individuals to remain in power and it cannot afford to alienate groups and break the coalition. Secondly, the situation is particularly fluid because the strong ideological differences that existed up to the 1980s have now disappeared. This enables politicians to switch allegiances with much greater alacrity than was the case in the past. It maintains a perception that the government's hold on power is always rather fragile, strengthens patronage politics and in many ways legitimises rent-seeking behaviour, while widening competition for rents.

In terms of the theoretical models of corruption, the current regime in Sri Lanka possesses elements of two behavioural types. First, as Shleifer and Vishny (1993) point out (and as mentioned in many private discussions in Sri Lankan business circles), the economic outcome of decentralised corruption is greater economic inefficiency. Each corrupt politician, bureaucrat or military officer acts with no regard for the impact of his or her rent extraction on other people, and economic agents face higher costs because they are forced to pay a bribe but cannot be sure that they will not have also to pay others. Second, economic efficiency is lower with a 'roving bandit' than with a 'stationary bandit'. A stationary bandit expects to share in any future wealth that is generated by the community and is therefore loathe to 'kill the goose that lays the golden egg'. A roving bandit has no such expectations and maximises the loot that can be extracted in the short-run.

Clearly, those in opposition during the UNP period who experienced the political muscle of the increased funding and largesse that had come with liberalisation learned their lesson well. But, as described earlier, the differences between a weak coalition and a powerful, centralised government (particularly that of Premadasa) affect its rent-seeking behaviour in important ways. First, compared with the Premadasa regime, there is a 'democratisation' of corruption. Second, the fragility of its grasp on power makes its behaviour closer to a roving bandit than to a stationary bandit model. Politicians are aware (even as they strive to maintain their hold on power) that they might not be around to capture potentially larger future rents from a growing economy—gains that could only be obtained by sacrificing current rents. As the planning horizon shortens, incentives to implement longer-term growth-oriented policies are lowered. Thus we seem to have a regime that corresponds to a theoretical model of 'a plurality of roving bandits'. This combination of the features of both theoretical models leads to the same efficiency conclusion: a band of many roving bandits provides a worst case scenario.

So what is the scenario for the future? We have so far ignored two key agents, namely the country's business community and the wider public. Nearly a quarter century after the initiation of liberalisation, the business community has expanded significantly, exploiting opportunities presented by the more liberal economic framework, however much it was distorted by the political programmes of governments. It appears to be ready to exert itself more directly in the political arena as shown by its first independent foray into the political sphere to lobby for a negotiated peace to the ethnic conflict. Clearly it has a strong interest in the political process, given that a slide into political and economic chaos threatens its basic interests. Second, the wider Sri Lankan community has a long tradition of struggle to defend both its vital economic interests and broader democratic and civil rights. The longer-term scenario for Sri Lanka will depend heavily on the nature and extent of the intervention of these agents in the political arena in the coming months and years.

Conclusions

The global movement to liberalise economies has not always produced the beneficial results that were expected of it. Indeed, in some cases it has led to economic recession, political chaos and social disintegration. So why has this happened? The voluminous literature that exists on Sri Lanka's economic policy reforms since the late 1970s assumes, almost as a matter of course, that they had nothing whatsoever to do with the subsequent socio-political decay. If anything, it is the latter that is seen to have held back the beneficial effects that would otherwise have occurred.

While much has been achieved by opening up the economy, stimulating entrepreneurial activity and promoting export growth, we have argued that the liberalisation process has also to be seen as a major explanatory factor in the socio-political downturn, reflecting specific characteristics of the Sri Lankan social, institutional and political setting, the enormous potential gains that the transition offered, and the particular way in which individual reforms were designed and implemented. The Sri Lankan setting has been moulded by a long history of patronage, and by a strong religious-ethnic and class divide as organising principles. We view the policy package as having been the outcome of conscious political (rather than purely economic) choices geared to strengthening patronage networks and buttressing political support. Over a period of some two decades, a package that included economic policy liberalisation (but also the PSIP, a new constitution with the executive presidency, and deliberate attack on the checks and balances of a democratic society) set the country on a path of socio-political decay. Once on this path, economic reforms often produced outcomes that were unexpected and undesirable, and which served to accelerate and to reinforce the steady downward spiral. Given the important similarities in social and political institutions, what has occurred can perhaps in some ways be seen as a South Asian phenomenon, with implications for further the future trajectories of countries such as India that are undertaking liberalisation.

Douglas North (1996:353) concluded in his Nobel lecture that: "..transferring the formal political and economic rules of successful Western economies to Third World or Eastern European economies is not a sufficient condition for good economic performance. Privatization is not a panacea for poor economic performance". We would go further in the light of Sri Lankan experience. Not only are they insufficient to ensure good economic performance but, in specific settings, they may produce little short of social and economic disaster. The Sri Lankan experience confirms that far more is needed than purely technocratic policy solutions. Reform programmes -- if they are to have broad-based success -- should not only address fundamental economic issues but should also be tailored to 'fit' specific institutional settings. And, when major class, ethnic or religious fault lines exist in society, the reform process needs to be very carefully managed. Policies have to be sensitive to multi-faceted distributional issues, account must be taken of the predictable responses of different actors, and trade-offs have to be made to maintain social cohesiveness. But for this to become a sustainable reality there must be legal and political institutions with adequate checks and balances to protect democratic freedoms. The revival of the economy and the reinvigoration of society both require an immediate political response. The rapid abolition of the executive presidency seems a first essential step on what will be a long and difficult journey if Sri Lanka is to achieve a prosperous economy with social harmony and a vibrant democracy.

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Notes

1. Many of the arguments in this essay are elaborated in greater detail in "Economic Liberalisation and Socio-Political Decay: a case study of Sri Lanka", paper presented to the Development Studies Association Annual Conference at the University of Manchester, 10-12 September 2001.

2. Of course, not all Tamils suffered. In the wake of the previous shortages, the immediate benefits of import liberalisation were widespread, and the urban middle class and those who controlled trade (including wealthy Tamil commercial interests) gained quite disproportionately.

3. The government's political agenda was also of course part of the wider ideological-political imperatives that drove cuts in the food subsidy. Washington institutions, particularly the World Bank, had long pushed for removal of consumer subsidies and its motives can only be understood in the broader context of its global policy agenda.

4. World Bank (2001):1

5. It did not involve trade and exchange rate liberalisation so much as the dismantling of state controls over domestic and international trade, the freeing of capital flows and financial markets, and the drastic reduction of state ownership, including areas such as basic public utilities, traditionally considered the natural domain of the public sector.

6. See, for example, papers in Elliot (1997). Robinson(1998), reviewing the failure of most anti-corruption measures in developing economies goes so far as to speculate that "....it may be that privatisation offers the only viable prospect of curtailing corruption in the third world" (p.158).

7. See, for example, Murphy, Shleifer & Vishny (1992).

8. The conventional view that liberalisation generates growth and eases competitive pressures (by increasing the size of the economic pie), and that it reduces gains that can be made from discretionary use of state power (is no longer adequate in the face of experiences in former Soviet bloc countries and elsewhere. For a discussion of issues related to the links between liberalisation and corruption, see Rodrik (1994) and Elliot (1997).

9 The fact that there are now some 30,000 deserters from the armed forces are considered an important contributory factor for the upsurge in violent crime (*The Sunday Times*, Colombo, 24 December 2000).