



Economic Freedom THE PATH TO ECONOMIC CUM POLITICAL RENAISSANCE OF THE CONFLICT REGION

1. Introduction

Sri Lanka is slowly but surely emerging out of a vicious civil war that has lasted over twenty-five years (July 1983 – May 2009); armed conflict since 1972; and the conflict per se ever since independence in 1948. The amount of human, material, environmental and psychological destruction caused by this long drawn out civil war, especially in the conflict affected Eastern and Northern Provinces, is immeasurable and would last for generations; although some quantitative and qualitative estimations do exist (Arunatilake, et al, 2000; Gunatilleke, 2001; Sarvananthan, 2008; Somasundaram, 1998).

The purpose of this policy brief is to set out the contours of a broad political and economic policy framework for rebuilding the conflict region (Eastern and Northern Provinces) from the ashes. It is not intended to get into specific sectoral or sub-sectoral strategies, policies, programmes or projects. On the contrary, it charts out a political cum economic

path that should be followed by the conflict region, and an enabling environment that the national government should create and foster for speedy recovery from the ruins. Economic resurrection of the conflict region, undoubtedly, would have a spillover effect on the national economy as well.

Japan and Germany are two prime examples of successful resurrection of battered minds and economies after ruinous adventures of war. Imperial Japan and Nazi Germany pursued a militaristic path for dominance of their respective geographical regions of the world. In the same way, the Liberation Tigers of Tamil Eelam (LTTE or 'Tamil Tigers' for foreigners) waged a relentless and ruthless war for the separation of the Eastern and Northern Provinces from Sri Lanka. The consequences have been disastrous for the Tamil minority community in particular, and for Sri Lanka as a whole. Though the Japanese and German military pur its of dominance were transnational wars, LTTE's

separatist war was internal. However, it could be argued that, though in pretence LTTE's war against the Sri Lankan state was internal, its ultimate intent was to create a pan-Tamil national state based in the Eastern and Northern Provinces of Sri Lanka (Bandarage, 2009; Sarvananthan, forthcoming). However, we frame the LTTE's war of separation (whether national or the transnational), as a matter of fact. LTTE was an institution that resembled militaristic adventurism of the regimes of Imperial Japan and Nazi Germany in the run up to and during the Second World War. The modus operandi of the LTTE also has a close resemblance to the Pol Potist regime of Kampuchea (now known as Cambodia) in the late-1970s (Sarvananthan, forthcoming).

As Sri Lanka enters a post-LTTE era after a nasty war of attrition and the consequent comprehensive defeat of the LTTE and elimination of its military cum political leadership, it is time for introspection, self-criticism and remorse by the Tamil community and to chart a way out of the current morass.

There are two potential pathways ahead for the Tamil community in particular, and Sri Lanka as a whole. One is that pursued by Japan and Germany in the aftermath of the Second World War, and the other followed by post-Khmer Rouge Cambodia.

Post-Second World War Japan and Germany rebounded from ashes following pacifism, resolute adherence to democracy cum rule of law, and industriousness; as a consequence became economic powerhouses in the world within a short span. On the other hand, Cambodia is dogged by democratic deficit, corruption, nepotism and low-intensity authoritarianism even after the ouster of Khmer Rouge regime in 1979 and end of Vietnamese occupation in 1989; thereby continues to be one of the poorest countries in the world. Thus, whilst post-war Japan and Germany reflect prosperity, post-war Cambodia reflects pauperism.

It is imperative for the people of Eastern and Northern Provinces in particular, and Sri Lanka as a whole, to draw lessons from historical experiences of these two sets of contrasting post-war countries. Naturally, I would argue in favour of the path pursued by both Japan and Germany in the aftermath of the Second World War for the Eastern and Northern Provinces in particular and Sri Lanka as a whole to pursue in this post-war (not yet post-conflict) era.

2. Economic Freedom

A laypersons definition of Economic Freedom is the freedom to do business locally, nationally and internationally with minimal cost and minimal interference of the local, national and international governments. Economic freedom is an essential ingredient of democracy like political freedom. Yet economic freedom is less understood, and even less underscored, compared to political freedom.

According to Gwartney and Lawson (2008: 3) "the key ingredients of economic freedom are personal choice, voluntary exchange, freedom to compete, and protection of person and property." A country's adherence to economic freedom is measured by the Economic Freedom of the World (EFW) index developed by the Fraser Institute based in Vancouver, Canada. The EFW index is based on 42 variables (including 22 survey-based variables derived from the International Country Risk Guide, Global Competitiveness Report and Doing Business Report of the World Bank). The EFW index has a scale of 0 to 10: zero depicting no economic freedom at all, and 10 depicting highest economic freedom. The EFW index is subdivided into 5 major components: (i) Size of Government: public expenditures, taxes and public enterprises; (ii) Legal Structure and Security of Property Rights; (iii) Access to Sound Money; (iv) Freedom to Exchange with Foreigners; and (v) Regulation of Credit, Labour and

Business. Further, the 'Size of Government' is subdivided into 5 components; 'Legal Structure and Security of Property Rights' is subdivided into 7 components; 'Access to Sound Money' is subdivided into 4 components; 'Freedom to Exchange with Foreigners' is subdivided into 9 components; and 'Regulation of Credit, Labour and Business' is subdivided into 17 components (Gwartney and Lawson, 2008: 5). Hence, altogether 42 variables compose the EFW index.

De Soysa and Fjelde (forthcoming) have proved that economic freedom and liberalisation are less likely to lead to armed conflict and civil war. Further, there is a positive correlation between economic freedom and economic growth, per capita income, life expectancy, poverty, income inequality, literacy rate, access to safe sanitation facilities and safe water (see Gwartney and Lawson, 2008: 18-21 & chapter 2). Moreover, Eriksen and de Soysa (2009: 496-498) have proved that there is a positive relationship between economic freedom and human rights; i.e. higher the economic freedom index, better the condition of human rights in a particular country.

Based on the conceptual framework of economic freedom as noted above, we would argue that the guiding principle of economic renaissance in the conflict-affected region of Eastern and Northern Provinces should be economic freedom, whereby the national and provincial governments should create an enabling environment for private sector led economic emancipation of the people, with private cum public partnerships where absolutely necessary.

3. Accountability, Integrity and Transparency

Accountability, integrity and transparency should be the cornerstones of provincial and local governments and provincial and local public administrations in the conflict region, as well as the rest of the country. A vibrant market economy could function effectively only when rule-of-law is supreme; merit and productivity are sine qua non; accountability, integrity and transparency are paramount.

In order to attain such an ethical system of governance, independent, efficient and credible Departments of the Auditor General, Bribery Commission, Public Services Commission, Police Commission, Human Rights Commission, and the Media are indispensable. The existing similar national level institutions are limited in scope and heavily politicised.

Due to many shortcomings in the national institutions, each province should set up regional institutions to foster good governance within its province. The corresponding national institutions could undertake the oversight of the provincial institutions. When we have truly

independent, impartial and non-partisan governance institutions such as the foregoing, external interference or interventions on governance in the country would become irrelevant.

Moreover, an equal opportunities law should be enacted in order to stamp out discrimination based on ethnicity, religion, gender, caste, regional origin, physical disability, political party affiliation, etc and promote a merit-based system of economic, social, and political governance. On this score, the conflict-affected provinces should become exemplary to the rest of the provinces and the national government.

4. Education and Knowledge Economy

Historically, the bedrock of regional preeminence of the North, particularly the Jaffna peninsula, has been education and knowledge. It is time to spread that to the East as well. Relatively, the North is endowed with marginal natural resources in comparison to other provinces. Therefore, education was the pathway to prosperity by way of entering the professions and public sector employment. Thus, the competitive advantage of the people of the North has been education and knowledge (human capital).

Although the Eastern and Northern Provinces are touted as primarily agricultural cum fisheries economies, it is no more the case due to the protracted civil war, resulting in mass displacement, mining of agricultural lands and coastal areas, and the exodus of kith-and-kin overseas, causing a 'demonstration effect' to migrate domestically or overseas (Sarvanathan, 2006 & 2008). During the conflict time, the services sector was the largest contributor to the provincial economies (over 65%), which was larger than the services sector's share in the national economy (just over 50%). However, presently (and in the past) the services sector in the two conflict-affected provinces is dominated by the defence and public administration sub-sectors that have minimal productivity (Sarvanathan, 2008).

These minimal-productive services sub-sectors could and should be transformed into highly productive, modern knowledge based economies in order to compete in a globalised market place. The emerging economies in the conflict-affected provinces should seize this opportunity to foster and promote a knowledge-based economy. Information technology and the English language are two indispensable ingredients of a knowledge economy. Besides, totally independent private schools and tertiary educational institutions (such as universities and technical/vocational higher education colleges) are also indispensable to build a knowledge economy. State-owned and run schools, universities, and further/higher education institutions should be made to compete for students with corresponding private institutions. The state

should provide financial resources directly to needy students so that they could buy the educational services from either the public or private institutions according to their own choice.

5. Fiscal Autonomy

In the post-war Sri Lanka, the national government should abdicate most of its functions and responsibilities to all nine provinces, except monetary currency, defence, and foreign affairs. The national government's primary function should be regulator of the provincial governments under a unified country, such as imposing a cap on provincial budget deficit. In order to fulfill its functions and responsibilities, provincial governments should be given fiscal autonomy. That is, the power to raise and earn income and spend on public services within the respective provinces. Each province should impose and collect taxes, except import duty, excise duty, and value added tax on imports. Hence, the national government's revenue should primarily accrue from duties and taxes on international trade. Businesses within each province should register with their respective provincial government and pay taxes (both direct and indirect) to their respective provincial government. Both the public and private sector employees should pay income tax to their respective provincial government. At the same time, national government employees (such as the Central Bank staff, employees of the three armed forces, Ministry of Finance employees, et al) should pay income tax to the national government.

By providing fiscal autonomy to provinces, the national government could promote competition among provinces to attract businesses and investments (both domestic and foreign). The fiscal space envisaged by the aforementioned method to the provinces would create an environment for productive competition among provinces. The national government should do away with the nanny state it currently operates, vis-à-vis the provinces, by providing annual grants to the provinces based on certain criteria. Present transfers from the centre to the provinces are barely adequate to pay the salaries, pensions, and recurrent expenditures of the provinces. On the contrary, the provinces should be encouraged to earn and spend their own money.

The total revenue of the national government is insufficient to meet even the recurrent expenditures of the government for the past twenty years (since 1989). Therefore, part of the recurrent expenditure and entire capital expenditure of the government is financed through domestic and external borrowings. Furthermore, a bulk of the annual government revenue goes for repayment of public debt (both domestic and external). Therefore, it is high time the national government thinks out of the box to fix its fiscal hole by transforming the nature, content and extent of the fiscal architecture

of the national government vis-à-vis provincial governments.

The Government's avowed strategy of economic revival of the conflict region is focused on physical (dwellings, roads, bridges, etc), economic (electricity, water, telecommunications, railways, etc), and social (schools, hospitals, etc) infrastructure development, which is indispensable. However, I have serious reservations about the financing of such infrastructure projects. Given the very tight fiscal space of the government as noted above, I do not think the government has adequate resources to finance such infrastructure development, because they are costly. Moreover, in the context of the global financial crisis, coupled with the precarious external political relations of the government, it is unlikely that the government will be able to mobilise adequate concessionary finance from external donors (both bilateral and multilateral).

In this scenario, the only option left for the government is to attract private capital (both domestic and overseas) for investment in infrastructure in the conflict region and beyond, under BOO (Build, Operate, and Own) or BOT (Build, Operate, and Transfer) mechanisms. The government's attempt to re-build the rail line beyond Vavuniya up to Kankesanthurai (in the Jaffna peninsula) is laudable, because the northern rail line (legendary 'Yarl Devi') used to be the highest revenue earner for the Ceylon Government Railways (CGR) prior to its termination in the mid-1980s as a result of the civil war. Besides, rail transport is cheaper than road, ocean or air transport due to lower fuel cost per passenger, and the absence of traffic congestion and security checkpoints.

However, I do not think the government has sufficient financial resources to spend on this ambitious and worthwhile project. The government is explicitly appealing to the people for contributions, and Sri Lanka's diplomatic missions abroad are organising 'benefit shows' to mobilise finance from the diaspora, which are highly unlikely to yield the desired results. According to the Central Bank (2008: 69), the Department of Railways incurred an operating loss of Rs.12.5 million every single day during 2008 (annual loss was LKR 4,553 billion or approximately USD 43 million). Our suggestion is that, whilst the government could invest its own money as well as borrow from a foreign donor/s to re-build the rail tracks and stations (infrastructure), it should open up the passenger transport to the private sector (both domestic and foreign). That is, locomotives and rail cars/carriages could be invested, managed, and operated by the private sector. This kind of public-private partnerships could be the best way to beat the fiscal crunch faced by the government. Although the national government should re-build the rail tracks and stations initially, the maintenance of the

same should be handed-over to the respective provincial government.

6. Conclusion

The comprehensive and decisive defeat of the LTTE provides challenges and opportunities. Tamil political leaderships and the national political leaderships should transform themselves to meet the challenges of post-war Sri Lanka and seize the historical opportunities it has bestowed. The broad policy framework we would suggest for post-war Sri Lanka in general, and the conflict region in particular, could be summed up as follows:

1. Economic strategy – Economic freedom as the guiding principle in the conflict region as well as the rest of the country, both provincially and nationally.
2. Cluster strategy – A knowledge economy is the key to economic renaissance and the leapfrogging of the conflict region to catch up with rest of the country.
3. State reform – Transformation from a nanny state to an empowering state.
4. Political reform of the Tamils – Transformation from a parochial linguistic cum ethnic identity towards a regional identity.
5. Governance reforms – Truly independent governance bodies that would safeguard and promote democracy and ensure justice and rule-of-law.
6. Financing the foregoing reforms – Fiscal autonomy is key to the realisation of the foregoing economic cum political reforms.

The need of the hour for Sri Lanka is statespersons & the likes of Nelson Mandela and F.W. De Klerk from both sides of the ethnic divide. Although a potential candidate from one side is Mr. Veerasingam Anandasangaree, I am yet to discover a potential candidate from the opposite side. Wish I were proved wrong. The spirit of the people of Sri Lanka, particularly of those in the conflict region, should be the likes of the Japanese and the Germans in the aftermath of the Second World War. Together we rise from the ashes, or bury ourselves. It is a make or break situation. Would those who dare to hope stand up please?

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