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The Politics of International Aid and New Asian Donors: Prospects for Peace and Reconstruction in Sri Lanka

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The United States' government that wields considerable influence at the International Monetary Fund (IMF) has sought to delay the US\$1.9 billion loan appeal by Sri Lanka in the context of an unfolding humanitarian crisis in the island. The Sri Lankan government, which has promised that it is at the end of its endgame with the Liberation Tigers of Tamil Eelam (LTTE), is seeking funds for the reconstruction of the northeast conflict-affected region, among other things. Colombo argues that it is fighting a 'war on terror'. Clearly, Colombo needs the IMF loan to service its external debt as a result of soaring defence expenditure and external borrowings which are also related to controversial oil-hedging deals.

The United Nations (UN) Security Council had earlier determined that it would not block the IMF loan to Sri Lanka when the subject came up at an informal UN Security Council discussion. However, it may revisit this determination following what the UN has termed a "bloodbath" on the day after *Vesak* in the northeast. Here, civilians are trapped in the stand-off between the military and the LTTE which is using them as a human shield. Earlier, the UN Security Council's president, Mexican Ambassador Claude Heller, had said that "all 15 members agreed that such a move or other steps to punish Sri Lanka were unnecessary." The island's two main donors, China and Japan, along with Russia and Vietnam on the UN Security Council, regard the violent conflict between the Sri Lankan government and LTTE as an internal matter. China recently overtook Japan as Sri Lanka's largest donor. The island is strategically located on one of the world's busiest shipping lanes.

The currently pending IMF loan has re-opened an old debate on international aid, and its relevance and effectiveness, both within and beyond Sri Lanka. The IMF had almost run out of relevance and, more significantly, clients in the developing world before the current global financial crisis. This was partly due to the unpopularity of the Structural Adjustment Programs and other aid-related policy conditionalities imposed by the Washington Consensus in the heydays of neo-liberal development thinking. The institution had also lost considerable credibility during its response to the East Asian financial crisis in the 1990s and its handling of the Argentina crisis in Latin America, particularly in the wake of World Bank Chief Economist, Joseph Stiglitz's critique that the IMF policies actually exacerbated these crises.

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Stiglitz, subsequently, lost his job at the World Bank but he won the Nobel Prize for Economics and now teaches at Columbia University.

The IMF's diminished relevance prior to the current financial crisis was also due to the emergence of new Asian donors with billions of dollars, such as China and India, moving into Africa and Asia on the account of the need for natural resources to sustain growth at home. Following the global financial crisis, this particularly Bretton Woods twin received a new lease of life to assist poor countries affected by the global economic downturn at the G20 Summit in London when it garnered pledges in the billions to help economic recovery. However, at the same London Summit, British Premier, Gordon Brown, had also declared that the "Washington Consensus is dead". Perhaps he followed in the English tradition of announcing, "The king is dead! Long live the king!" In any event, it appears that the IMF may now step in where the World Bank once trod; the latter being the Bretton Woods twin tasked with post-conflict reconstruction. It is generally agreed that Sri Lanka's current economic woes are more related to soaring defence expenditure, dysfunctional governance and corruption that have fuelled and have been fuelled by the extended armed conflict with the LTTE rather than the global economic crisis.

Three years ago, Sri Lanka turned down an IMF offer of the status of a Heavily Indebted Poor Country (HIPC Initiative) and the Mahinda Rajapaksa regime celebrated the departure of the IMF with fanfare, and the promise never to go back to western aid conditionalities which often included the privatisation of public corporations and assets, underperforming or otherwise. Since then, Sri Lanka's Central Bank had followed a path of borrowing from private capital markets, having concluded that concessionary loans offered by international financial institutions were too costly, given aid conditionalities, including over-priced technical assistance from donor counties that amount to "phantom aid". Not so long ago, the Governor of the Central Bank of Sri Lanka went on record to tell the IMF to put Washington's finances in order following the global financial crisis rather than advising Sri Lanka on monetary policy.

Sri Lanka currently suffers from a homegrown balance of payments crisis related to defence expenditure, a bloated public sector and inflation that peaked last year at 30 percent, when the official reserves were whittled away defending an exchange rate which was pegged at 108 Rupees to the United States Dollar. According to Razeen Sally, Director of the European Center for International Political Economy, an apparent balance of payments crisis is also related to "corruption and institutional rot that set in long ago but has plumbed new depths". Currently, controversial oil-hedging deals are under investigation by the Bribery Commission on the complaint to the Central Bank, following a Supreme Court stop-order on oil-hedging payments by Ceylon Petroleum Corporation, including to Citibank and Standard Chartered Bank. Recently, the United National Party, the main opposition, raised questions about conditionalities attached to the IMF loan in parliament in Colombo. The Sri Lankan government has stated that it will not tolerate conditionalities from the IMF which would very likely welcome a client from South Asia given its declining clientele in the region.

Historically, Sri Lanka has been a little bit of a 'donor darling'. The country tends to underutilise normal development assistance (at around 17-35 percent depending on the project) and has experienced 'hot aid flows' as was the case following the Asian Tsunami disaster of 2004 when over 500 donors and international non-government organisations (INGOs) arrived in the island to provide relief and stayed on for several years. The aid experience after the Asian Tsunami disaster gave rise to a local discourse that the island had

been struck by an ‘aid tsunami’ that had caused new problems of coordination, equity and a lack of local ownership of recovery priorities and programme. Several studies indicated that a significant part of the funds were consumed by international experts from various UN Agencies, the International Federation of Red Cross and related Red Cross partners, and INGOs based in Colombo rather than reaching affected communities. The island’s lush tropical beauty, cultural openness, and tourist-friendly people and infrastructure, despite and arguably because of cycles of conflict, peace building, reconstruction and destruction in the last quarter century, means that it has been a favourite place for aid workers and the international development and humanitarian industry. It has been known for a while that international assistance in post-conflict situations may either ameliorate or contribute to conflict. Aid dependence in conflict situations may lead to institutional de-development and a form of aid-induced Dutch disease. It is in this context too that the Sri Lankan government has recently been quite dismissive of western aid donors.

The Tamil Diaspora, Information War and Aid Fungibility

“Politics in an information age is not only about whose military wins, but whose story wins” as Joseph S. Nye has noted. The Sri Lankan government is facing increased international pressure as it nears the end of the long war with the LTTE. Last month, Tamil diaspora groups held protests outside the IMF in Washington D. C. over the impending loan. On 5 May 2009, the Secretary General of the Paris-based Reporters Without Borders wrote an open letter to the IMF’s Managing Director, Dominique Strauss-Kahn, drawing attention to “the lamentable state of press freedom in the country and seeking ‘rule of law’ and human rights aid conditionality if the loan is passed. The missive from Jean-Francois Julliard, Secretary General of Reporters without Borders, noted, “As you know, Sri Lanka is spending as much as US\$1.6 billion on defence in its 2009 budget, a 6.5 percent increase on the 2007 allocation, while neglecting social needs. Some army units are implicated in war crimes. Others are suspected of responsibility for many cases of violence against journalists and human rights activists.”

Many western donors and members of the Organization for Economic Cooperation and Development-Development Assistance Committee (OECD-DAC), with significant Tamil diasporas in their capitals, are troubled by the humanitarian situation in a small strip of land in the northeast controlled by the LTTE where civilians trapped by the LTTE are being killed on a daily basis in the crossfire. The French and British Foreign Ministers visited the island recently after Sri Lanka denied a visa to the Swedish Foreign Minister. Their visit was to persuade the government to have a humanitarian pause for help for trapped civilians in the conflict zone but they returned empty handed. The government had insisted that the LTTE would use such a humanitarian pause to strengthen itself as it has done in the past. But the immediate humanitarian crisis and the fact that there are significant Tamil diaspora groups in many OECD-DAC countries and that they have been holding protests may be only part of the problem with releasing an IMF loan. There is also the question of the fungibility of aid and the usage of an IMF loan by the Sri Lankan government.

If the IMF loan sought is US\$1.9 billion and the Sri Lankan government’s defence expenditure is US\$1.6 billion, the question of the fungibility of aid or the ability to transfer donor resources to non-targeted expenditure – a problem as old as foreign aid itself – inevitably arises at this time. The question remains – will an IMF loan subsidise the military machine of the government given fungibility? It is then arguable that conditionalities on an IMF loan should relate, not only to immediate humanitarian conditions to assist suffering

civilians in the conflict, but also extend to a sustainable solution and good governance for conflict de-escalation.

In the past, western donors have worked in tandem with each other and offered carrots and wielded sticks at successive Sri Lanka government to encourage peace and reconciliation. Thus, for instance, the peace process that ran between 2001 and 2007 between the Sri Lankan government and the LTTE was sweetened by the ‘international community’ with the promise of US\$4.5 billion that was pledged at the Tokyo Donor Conference in 2003. The peace at reconstruction was to be bought and overseen by four Co-Chairs of the Peace Process – Norway, the official peace facilitator at the time; Japan, Sri Lanka’s largest bilateral donor; the United States; and the European Union.

New Asian Donors: China and India in Sri Lanka

The current international aid configuration in Sri Lanka reflects shifting structural dynamics in the international development architecture, given the emergence of new Asian donors, particularly China and India, which tend to have a more state-centric approach to aid as well as the critique of aid in the global south. They may also be increasingly rendering the established aid structure irrelevant. The traditional OECD-DAC donors have been facing a declining influence with the emergence of the new Asian donors that have complicated the aid-trade debate. The new Asian donors tend to be less concerned with human rights conditionalities and have supported the Sri Lanka government in its confrontation with the LTTE. For instance, the Indian government has pledged reconstruction assistance after the conflict and has sent emergency humanitarian assistance to the conflict zones in northern Sri Lanka, including teams of navy doctors. Of course, the Indians have also supplied intelligence assistance to the Sri Lankan government in its confrontation with the LTTE and provided defence equipment of a non-offensive nature, principally radar equipment to detect LTTE planes.

Sri Lanka has suffered from the syndrome of being a ‘donor darling’. ‘Donor darlings’ tend to suffer from too many aid actors with small sums of money who place a high transaction cost on local institutions and deflect from addressing the pressing problems on the ground. In Sri Lanka, critical civil society groups have, for a while, and certainly since the aid that followed the Asian Tsunami disaster in 2004, called for less aid and better targeting and monitoring of international development assistance.

Given its increased strategic location on major shipping and trade lines linking the Far East to the Middle East, Africa and Europe, the island today counts on China and Pakistan for military and financial assistance to combat the LTTE. In the southern tip of Sri Lanka, 10 miles from one of the world’s busiest shipping lines lies a vast construction site. A port funded by the Chinese is being built on this site which is in the electorate of President Rajapaksa. Hambantota is one of the poorest districts in the island and China is building a US\$1 billion port there. In Colombo, it is building an arts and culture stadium. China says that the Hambantota port is a purely commercial venture but the United States and Indian military analysts regard it as part of a ‘string of pearls’ strategy whereby China is also building and/or upgrading ports in Gwadar in Pakistan, Chittagong in Bangladesh and Sittwe in Myanmar as it patrols the India Ocean against pirates and protects its Saudi oil supply route.

China has also helped Sri Lanka in other ways, including encouraging Pakistan to sell weapons to Sri Lanka and supporting it diplomatically by blocking attempts to put Sri Lanka on the UN Security Council agenda. China apparently provided free-of-charge six F7 jet fighters last year and, according to the Stockholm International Peace Research Institute, these planes shot down the LTTE mosquito planes. Chinese aid to Sri Lanka jumped from a few million dollars in 2005 to US\$1 billion last year, replacing Japan as Sri Lanka's largest aid donor. It also became its biggest arms supplier in the 1990s. As both India and China fish in Sri Lanka's strategically located troubled waters, the Sri Lankan government seems to be strategically using the rising Asian donors, in particular to defeat the LTTE and counter the western aid lobby that may increasingly face irrelevance in Asia.

Reconstruction Aid and Fungibility: Lessons from the Eastern Province

Elsewhere, I have suggested that the government would win the war but lose the peace. Many have predicted that the LTTE would melt into the people and into South India and continue its guerrilla war until the root causes of the conflict are addressed. A military victory by the government in no way addresses the 'root causes' of the conflict in Sri Lanka which can only be addressed by the devolution of power to the northern and eastern regions. Indeed, Tamil moderates could argue that now that the LTTE threat is passed, there should be meaningful power sharing rather than the masquerade of democracy that is evident in the east since the government apparently 'liberated' the eastern province. What exists in the east at this time is a distortion of democracy even though there were elections held.

The situation in the eastern province which was re-captured by the Sri Lanka military from the LTTE in mid 2007 and which is showcased as a post-conflict development model is instructive. The International Crisis Group (ICG) report on "Development Assistance and Conflict in Sri Lanka: Lessons from the North East" issued on 16 April 2009 notes, "Even now, the eastern province is still not the 'post-conflict' situation that development agencies had hoped. Despite the presence of tens of thousands of soldiers and police in the east, the LTTE have proven able to launch attacks on government forces and their rivals, the Tamil Makkal Viduthalai Puligal (TVMP). There have also been violent conflicts between different factions of the pro-government TVMP and impunity for killing and disappearances, many of them apparently committed by government forces and their allies. The government has still not devolved power to the eastern province as required by the Thirteenth Amendment to the Constitution which established the provincial council system in 1987 in response to Tamil demands for regional autonomy. The Governor of the province, appointed by the President, is blocking the council's initial piece of authorising legislation, and development planning and implementation continue to be run from Colombo and central government ministries. The government has yet to articulate any plans for a fair and lasting distribution of resources and political power that would satisfy all communities."

The ICG Report further notes that, "In this environment, development of the east remains affected by the conflicts and threatens to exacerbate them. Despite the need for development, there is a danger of funds being wasted or misused." The critique of development assistance within the country has, of course, also remarked that international aid itself has contributed in the past to the conflict scenario both because of poor governance locally as well as in the international aid system and bureaucracy due to phantom aid, lack of transparency about the amounts and conditions of aid as well as poor monitoring, evaluation and exit-strategies. In the context, it is to be hoped that, in a post-conflict situation in Sri Lanka, the IMF loan and other international aid would be conditional on a scenario where:

1. Moderate Tamil voice that had been stifled by the LTTE and para-militaries allied to the government would be heard again, and be incorporated into the post-conflict reconstruction planning and implementation process.
2. The military defeat of the LTTE does not mean that its ideology has been defeated. It is when the Sri Lanka state recognises and remembers once again that Sri Lanka is a multicultural, multi-religious and plural country, ensures that all communities have equal rights and the Tamil people feel like they are treated with respect and decency by the state will the ideology of the LTTE be defeated. The state will need to reach out to the minority community, ensure that displaced people are not held in internment camps but rather are properly resettled, and offer it an acceptable political solution. There also needs to be a process of reconciliation and peace building among the various ethnic and religious communities.
3. Affirmative action of hiring of minority community members into government institutions, bureaucracy and the armed forces. Unfortunately, like the LTTE, southern politicians have played the 'ethnic card' and used the conflict and war to win votes and stay in power. At the same time, they have destroyed a history of co-existence between various ethnic and religious communities in Sri Lanka. This political culture must end for bridges to be built and ethnic relations to improve in Sri Lanka.
4. The monitoring of the IMF loan and other reconstruction assistance at the macro-economic and project level by development experts and the civil society would be necessary, given the fact that, in the past, Sri Lanka has been subject to the phenomenon of what a report by Action Aid International titled 'Real Aid' has termed 'phantom aid'.
5. Finally, 'Trade not Aid' is the path forward for sustainable economic recovery and to avoid aid dependency and the related poverty and conflict trap that northeast Sri Lanka has been caught in for the last two decades.

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