

**UPDATE**

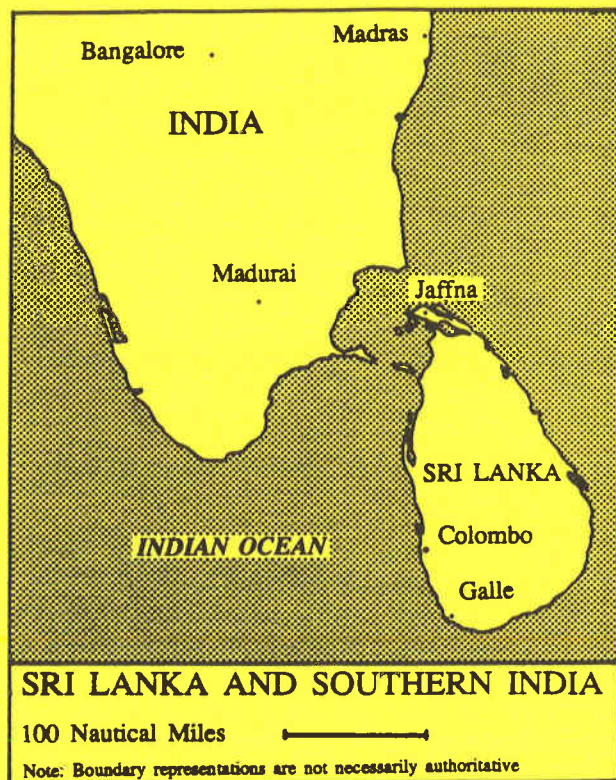
## SRI LANKA MERITS CONTINUED U.S. SUPPORT

(Updating Asian Studies Center *Backgrounder* No. 81, "A Guide to U.S.-South Asian Relations," October 14, 1988)

When India's Rajiv Gandhi was assassinated this week, Tamil separatists fighting in neighboring Sri Lanka were suspected almost immediately of being behind the murder. The Tamils, a minority ethnic group in northern Sri Lanka, had received covert military assistance from India early in Gandhi's 1984 to 1989 term as prime minister. But when the insurgency threatened to tear Sri Lanka apart, Gandhi in 1987 dispatched Indian peacekeeping troops to help the Sri Lankan government restore order. Ironically then, the Indian troops fought a bloody three-year war against the Tamil guerrillas that New Delhi earlier had supplied. While it is not yet known if Tamils were involved in killing Gandhi, his assassination highlights the ethnic violence that has engulfed Sri Lanka for nearly a decade.

The recent history of Sri Lanka, the country with a population of 17 million formerly known as Ceylon, has fluctuated wildly between extreme optimism and pessimism. In 1977, Sri Lankan voters, tired of failed socialist economic policies, elected Prime Minister Junius Jayewardene on his platform of free markets and closer relations with the West. He moved quickly to transform the island republic into a private enterprise showplace. The economy responded dramatically: real increases in gross domestic product (GDP) jumped from 3 percent in 1976 to 8.2 percent in 1978, the first full year of the free market strategy. Diplomatically, the new administration, while keeping Sri Lanka officially in the Non-Aligned Movement, ceased its anti-Western foreign policy and moved toward genuine neutrality.

This transformation was not without a price. Alarmed at Sri Lanka's quick and successful capitalist reforms and openness to the West, India began its covert assistance to the Tamil separatists fighting government forces in northern Sri Lanka. By 1987, the Tamil insurgency, which had been steadily building for five years, raged out of control, forcing Colombo to seek assistance from such diverse sources as Islamabad, London and Tel Aviv. Investor confidence plummeted, sending GDP growth in 1987 down to 1.5 percent. In a major policy miscalculation, meanwhile, the United States Embassy in Colombo enthusiastically supported New Delhi's 1987 plan to send Indian peacekeeping forces to Sri Lanka. This Indian force, which peaked at 53,000 troops, began arriving in August 1987. When it finally departed Sri Lanka in February 1990, its mission had failed and the country was more embroiled in civil war than it had been when it had arrived.



This plunged Sri Lanka early last year into deep pessimism. Yet by year's end, the country had shown surprising resilience. Boosted by a major privatization campaign and a pledge last October of \$1 billion in grants and loans by the Aid Consortium,<sup>1</sup> Sri Lanka's GDP last year grew nearly 5 percent. Government military forces, meanwhile, strengthened their hold over the embattled eastern portions of the country, and fought to a stalemate with the Tamils in the north.

Sri Lanka's immediate prospects look mixed. On the positive side is the economy. Despite the thousands of jobs lost by Sri Lankans who were working in the Persian Gulf on projects and at firms disrupted by the war, Colombo's strong private sector is expected to continue its 5 percent GDP growth in 1991. Sri Lankan officials like Minister of Industries Ranil Wickremasinghe, moreover, have been praised by the U.S. State Department for their support for privatization and incentives for foreign investors. On the negative

side, Tamil insurgents, whose terror tactics often rival Peru's infamous Shining Path guerrillas, show no signs of soon ending their costly insurgency. Colombo, moreover, has come under fire from international human rights groups for excesses in defeating the insurgency.

U.S. policy toward Sri Lanka, too, is mixed. Washington appreciates Colombo as a successful free market role model within the Non-Aligned Movement. Since last June, for example, Sri Lankan officials at the Uruguay Round of the General Agreement on Trade and Tariffs (GATT) talks strongly have supported the free trade policies advocated by Washington. Sri Lanka also gets points in Washington for last year approving construction of a major Voice of America (VOA) transmitter north of Colombo. This positive view is countered by Congressional critics, notably Representative Stephen Solarz, the New York Democrat, who fault Colombo's efforts to correct alleged human rights abuses committed by its armed forces. As a result, the Bush Administration, mindful of Congressional opponents, has refused to sell lethal military equipment to Sri Lanka and to grant "end-user" certificates to third countries that want to sell lethal U.S. weapons to Sri Lanka.

Washington's South Asian policy correctly is centered on relations with India. Sri Lanka, however, remains important for America as an economic, and potentially as a political, model for the Third World. As the Non-Aligned Movement's dissatisfaction with socialist policies grows, Colombo's economic example is likely to become even more important. To encourage continued economic growth while pushing for stability in Sri Lanka, the Bush Administration should:

<sup>1</sup> The Aid Consortium, consisting of the U.S., Australia, the European Community, Japan, and the Nordic countries, meets annually to coordinate aid pledges for Sri Lanka.



**Urge the Treasury Department and the U.S. Trade Representative to support applying the Double Taxation Agreement to Sri Lanka.** First proposed in the early 1980s, this agreement would encourage U.S. businesses to invest in Sri Lanka by taxing American investors in either the U.S. or Sri Lanka, but not in both countries. The Sri Lankan government in 1985 approved the measure; necessary support from the Treasury Department, which has been delayed by other trade priorities, should be sought as soon as possible by the Administration.

**Publicly support Sri Lanka in multilateral forums for its economic reforms.** Since last June, Sri Lanka openly has supported free market reforms in international forums like the Uruguay Round. U.S. officials privately have praised Colombo's principled stance. This is not enough. The Administration publicly should support Sri Lanka's free enterprise policies in multinational forums like the World Bank, the International Monetary Fund, and the Asian Development Bank. Washington this year should send a high-ranking delegation from either the Treasury Department or the United States Trade Representative's office (USTR) to Sri Lanka.

**Press Colombo to reform its labor and financing laws.** Sri Lankan labor laws still are rooted in its socialist policies of the mid-1970s. This discourages foreign investment for a number of reasons. Example: It is nearly impossible for foreign businessmen to fire local laborers. The Sri Lankan finance sector, meanwhile, is monopolized by two notoriously inefficient state banks. For the past two years, the World Bank has been urging reforms in these areas, and Sri Lanka slowly has started to respond. Washington publicly should press Colombo to scrap its cumbersome labor laws and announce plans for phased privatization of its banks.

**Increase training funds for Sri Lankan military officers in the U.S.** Last year the U.S. spent \$160 thousand to train Sri Lankan soldiers in America; the Administration has requested \$200 thousand for fiscal 1991. By comparison, Indonesia is allocated \$1.9 million and the Philippines \$2.6 million in training funds for fiscal 1991. Sri Lankans who train in America return home with a greater sense of discipline and respect for human rights, precisely the deficiencies that Congressional critics charge are lacking in the Sri Lankan military. To encourage greater discipline in Colombo's forces, the Bush Administration should seek \$400 thousand for Sri Lankan military training in the U.S.

Sri Lanka is not likely to see peace in the embattled north soon. Satisfactory resolution of past human rights abuses by both the government and the Tamils, too, will take time. While continuing quietly to press Colombo to correct human rights violations, Washington should not lose sight of the importance of Sri Lanka's free market success story. The Bush Administration should focus its Sri Lankan policy on promoting further economic growth. In doing so, internal security is likely to get its biggest boost from free market prosperity. Equally important, Sri Lanka's private enterprise experiment could become a model elsewhere in the Third World.

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