

CENTRO STUDI PER I POPOLI EXTRA-EUROPEI "CESARE BONACOSSA" - UNIVERSITÀ DI PAVIA

# ASIA MAIOR

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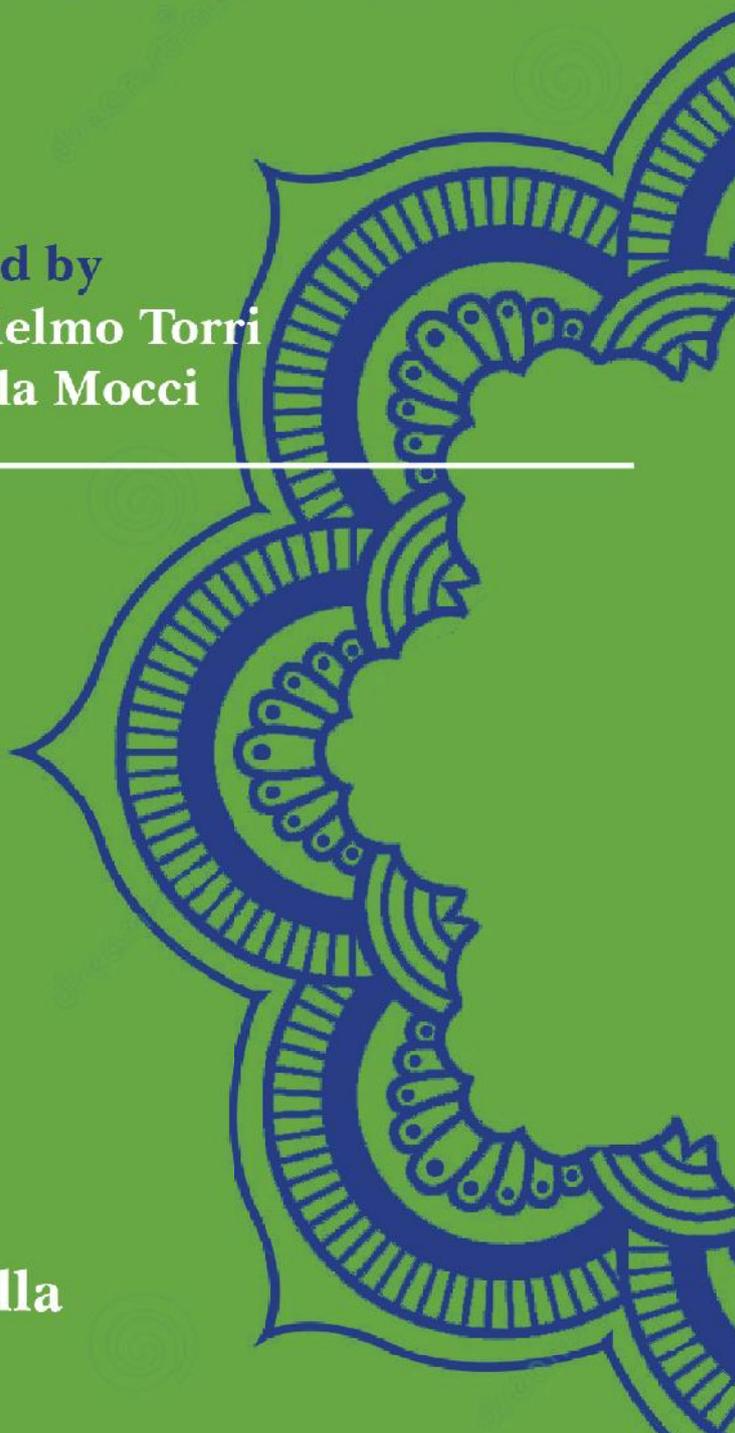
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## The End of the Obama Era in Asia

Edited by  
Michelguglielmo Torri  
and Nicola Mocci

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## SRI LANKA 2016: DOES THE NEW ERA CONTINUE?

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*The year under review witnessed the continuation of the new political phase in Sri Lanka, which began in 2015 with Mahinda Sirisena's victory at the presidential polls and, later in the year, the electoral victory of the United National Front for Good Governance (UNFGG) led by the United National Party (UNP). The Sirisena administration and the National Unity Government appeared to be engaged in re-establishing of the rule of law and the implementation of reconciliation measures. However, like in 2015, the government's efforts appeared to often be slow, limited and hesitant. Nevertheless the Unity Government was able to carry out at least some substantial democratic reforms.*

*In foreign policy, Colombo strengthened the relations with the United States and India but, at the same time, revamped those with Beijing – which had appeared to be on the wane during 2015.*

*From an economic point of view, the situation – which at the beginning of the year under review seemed to be positive and promising – later deteriorated, raising doubts about the government's political will and ability to implement economic reforms. Nevertheless, when presenting the new budget in November, the government's dual goals of addressing the systemic weaknesses of the economy and improving the conditions for the lower social strata were both in evidence.*

### *1. Introduction*

During 2015, Sri Lanka witnessed the rise of a new political phase, which began with the change of government in January and featured the progressive restoration of democratic governance.<sup>1</sup> In turn, 2016, the year under review, witnessed the continuation of this new political phase, which began the previous year with Mahinda Sirisena's Presidency and, later in the same year, with the formation of the National Unity Government – also known as the *Yahapalana* (Good Governance) Government –, made possible by the electoral victory of the United National Front for Good Governance (UNFGG) coalition led by the United National Party (UNP) in August 2015. Strengthened by a new majority in Parliament and a coalition agreement

1. For an in-depth analysis of the political and economic evolution of Sri Lanka in 2015, see Danila Berloff, 'Sri Lanka 2015: The Dawning of a new Era', *Asia Maior 2015*, pp. 407-43.

between the Sri Lanka Freedom Party (SLFP) and the UNP, the Sirisena administration and the National Unity Government continued the implementation of their reform agenda aimed at re-establishing the rule of law and implementing a reconciliation and justice mechanism. Like in 2015, however, the government's efforts appeared to often be slow, limited and hesitant. Nevertheless the Unity Government was able to carry out some significant reforms. Also, during 2016, the factional struggle within the Sri Lankan ruling class continued and became more intense. In particular it took the shape of a direct confrontation between Sirisena and the former Sri Lankan President Mahinda Rajapaksa for the control of SLFP leadership.

The new political phase characterized Sri Lanka's foreign policy as well. Colombo continued its policy of maintaining and consolidating equal relations with global and regional powers and closely engaging with its Asian neighbours. The relations with the United States and India became closer, both at the economic and military levels. In spite of this, the relationship with Beijing – which had appeared to be in trouble during 2015 – was marked by a progressive rapprochement.

Among the many challenges the government faced in 2016, there was the challenge of keeping the beleaguered economy afloat. At the beginning of 2016, the economic situation seemed to be positive and promising; however, it deteriorated in the second half of the year. This progressively worried the international economic community, raising doubts about the government's political will and ability to implement economic reforms.

This article is organized as follows. The first two sections focus on the reform measures of the Sri Lankan government. The third section takes into account the leadership struggle within SLFP. The fourth section is centred on Sri Lanka's relations with the US and India. The next section focuses on the rapprochement with China. Finally the last two sections analyse the economic situation and the budget respectively.

## *2. The difficult road of political reforms*

The results of the parliamentary elections held in August 2015 gave a strong majority in Parliament to Prime Minister Wickremesinghe's United National Party (UNP). President Sirisena cooperated with the UNP in the elections; furthermore the UNP and Sirisena's faction of the Sri Lankan Freedom Party (SLFP) formed a unity government and signed an agreement to work together for the reform agenda. Wickremesinghe was confirmed as Prime Minister. By then, with a strong majority in Parliament, President Sirisena and Prime Minister Wickremesinghe committed themselves to implementing the government's reform agenda.

The reworking of Sri Lanka's constitutional system was the most important reform advocated by the government. It aimed to achieve two main

goals: the abolition of the executive presidency (which was one of Sirisena's key promises during the January 2015 presidential election campaign) and the creation of an appropriate mechanism to meet the aspirations of the country's several ethnic communities. A resolution establishing a road map for drafting a new constitution was presented in Parliament on 9 January 2016. Speaking in Parliament, President Sirisena argued that the existing constitution – the Second Republican Constitution created in 1978 – not only allowed for elected tyranny in Sri Lanka (by concentrating power in an all-powerful presidency), but was also instrumental in exacerbating relations between the different ethnic communities, which had resulted in a 30-year civil war. Sirisena made clear that the government was firm on the abolition of the executive presidency. At the same time, the devolution of power to minorities would be the key feature of new constitution, in order to prevent domestic conflicts.<sup>2</sup> Wickremesinghe assured everyone that the drafting of the new constitution would be as inclusive as possible. He also pledged that the new constitution would not change the unitary character of the state or the constitutional priority given to Buddhism.

On 9 March, the Parliament unanimously approved the government resolution. In order to be accepted, the resolution had to undergo some significant changes. The major amendments from the opposition were accepted; among these were: the adoption of a provision for converting the entire Parliament into a «Constituent Assembly», and the deletion of a reference to the replacement of the executive presidency with the completely parliamentary system.<sup>3</sup> This move really prevented a boycott by the opposition – a dangerous situation which would have drawn accusations that the ruling party was imposing a new constitution without taking into account a significant section of the Parliament.

The resolution directed the Parliament be transformed into a Constituent Assembly, which would seek public input, make recommendations and prepare a Constitution Bill.<sup>4</sup> The Constituent Assembly would be chaired

2. 'Devolution to minorities the key issue', *The Hindu*, 9 January 2016.

3. 'Rajapaksa loyalists work out plans for new party and alliance', *The Sunday Times*, 17 January 2016; 'Sirisena isolating Rajapaksa, also brings UPFA under his fold', *The Sunday Times*, 13 March 2016.

4. Technically it was not a real «Constituent Assembly», but only a «committee of parliament», even though it comprised the Parliament's entire membership. Its task was to prepare a first draft (approved it with a two-thirds majority) and send it to the government. In turn, the Cabinet of Ministers would send the draft to all the provincial councils for their views, and thereafter place it before Parliament. Parliament – with the same composition as the assembly, but acting in its full legislative and constituent capacity – would approve the Constitution with a two-thirds majority of the total number of members in the House – or reject it. Thereafter, if the Constitution was approved by Parliament, it was to be submitted to the people, which was to approve – or reject – it through a referendum. K. Venkataramanan 'In the throes of political reform', *The Hindu*, 6 January 2016.

by the Speaker of Parliament and would elect seven Deputy Chairmen. The resolution also mandated the creation of a steering committee of 17 members, which would supervise the discussion and drafting of the new constitution.<sup>5</sup> The word «new» was deleted from the title («New Constitution for Sri Lanka»). This caused a certain degree of ambiguity, as, while not precluding the drafting of a completely new Constitution, it left open the option of just revising the existing Constitution. Moreover, a decision on the future of the executive presidency was avoided.<sup>6</sup>

In early April, the first parliamentary steering committee meeting on the drafting of the Constitution was held. The consultations on constitutional reforms were successful and were conducted seamlessly and transparently.<sup>7</sup> However, the Constitutional reform debates tended to focus almost exclusively on the executive issue and the electoral system. Most political parties expressed the opinion that the executive presidency must remain.<sup>8</sup> The other main controversial issues remained on the margins of the debates, such as the idea of having a federal system. This issue was left undressed, despite the pressure applied by some minorities.<sup>9</sup>

In May the Public Representations Committee, tasked with gathering ideas from the public, issued its report. It endorsed a range of bold reforms, including the incorporation of a bill of rights. It failed to reach agreement, however, on an expanded devolution of power to minorities and on adopting a federal set-up for the country. Moreover, with parliamentary consensus likely to fall well short of the long-standing minorities' demands for federalism, the government could face a major challenge in winning their support in the referendum needed to approve the constitutional reforms.

5. The Steering Committee consisted of the Prime Minister (Chairman), the Leader of the Opposition, the Leader of the House, the Minister of Justice, and no more than 11 other Members of the Constitutional Assembly elected by the same Constitutional Assembly. 'Sri Lanka kick-starts process to adopt new statute', *The Hindu*, 9 January 2016.

6. 'Debates within ruling coalition over executive presidency', *Sunday Observer*, 17 January 2016.

7. 'Transparency Key as Rights Commission Deadline Looms', *Human Rights Watch*, 25 April 2016.

8. The SLFP bigwigs made it clear that they supported the Executive Presidency and opposed its total abolition, arguing that its abolition would «weaken» the country's system of governance. The UNP was silent on the matter. Paradoxically this position was also supported by minority parties. 'Proposed Constitution: Division on Executive Presidency and 13A', *The Sunday Leader*, 17 July 2016.

9. In April, the Tamil National Alliance (TNA) adopted a resolution aimed at supporting the federal solution. Similarly, ten Tamil parties and groups formed a coalition – the Democratic Tamil National Front – in order to campaign for the adoption of the «Indian model of federalism». 'Federal system not meant to divide Sri Lanka: Northern CM', *The Indian Express*, 30 April 2016; T. Ramakrishnan 'Tamil parties form new coalition in Sri Lanka', *The Hindu*, 6 May 2016.

The introduction of the long-awaited Right to Information Act (RTI) represented a significant step forward in restoring the rule of law. In January 2015, Sirisena had promised to establish a Right to Information law as part of his so-called 100-day plan, once in office. In May, the bill was placed on the order paper of Parliament. However, four separate petitions challenged its constitutionality. The Supreme Court declared that some Sections of the bill were inconsistent with some sections of the Constitution.<sup>10</sup> The government accepted the changes suggested by the Supreme Court and presented the bill again in Parliament. The Right to Information (RTI) Bill was approved by Parliament on 24 and 25 June. In accordance with it, a Right to Information (RTI) Commission was established, and staffed with personnel from the organizations of publishers, editors and media as well as other civil society organizations. The Act ensured citizens' access to information, barring the cases in which this would endanger the country's national security.<sup>11</sup> The law is supposed to act as a deterrent to those flouting government rules and regulations in all sectors.

While the above listed efforts by the government to implement the reform agenda were on the whole successful, others came to standstill. For example, the reform of the electoral law continued to be a controversial issue even within the government and no agreement on it could be found. Similarly, the government continued to be reluctant to abrogate the Prevention of Terrorism Act (PTA). Indeed, the Government claimed that the adoption of some important legal and institutional reforms was very close. These were supposed to include legislation to replace the repressive PTA with new laws consistent with human rights standards, as required by the UN Human Rights Council resolution (on this see below). However these measures never saw the light of day. Arrests under the PTA continued and the government has still not put forward a plan to provide redress for those unjustly detained under the PTA.<sup>12</sup> Moreover a proposed amendment to the country's criminal law, presented in August, opened further controversies. It aimed at introducing a new sub-section to the Criminal Procedure Code (CPC) which would deny access to lawyers for arrested suspects prior to the recording of their statements.<sup>13</sup> In addition, no progress was made in combating corruption, as shown by the fact that, despite the government's rhetoric, no National Audit legislation was enacted.<sup>14</sup> This new law was ex-

10. 'SLFP decision-making bodies lose control over members: Forty MPs at Kirulapone rally', *Sunday Observer*, 8 May 2016.

11. Rohantha De Silva 'Sri Lankan government presents phony «Right to Information» bill', *World Socialist Web Site*, 4 April 2016.

12. Subash Somachandran & S. Jayanth, 'Sri Lankan government refuses to release Tamil political prisoners', *World Socialist Web Site*, 15 March 2016.

13. 'Sri Lanka: Human rights body frowns over denial of lawyers to suspects', *The Indian Express*, 23 September 2016.

14. 'Civil society groups demand quick action: Cabinet defers paper on anti-corruption delays', *Sunday Observer*, 22 May 2016.

pected to confirm and expand the powers of the Auditor General, as well as the role and independence of the office. However, although the proposed National Audit Bill became a widely discussed topic, it remained in the form of draft legislation and, by the end of the period under review, had yet to be approved.<sup>15</sup> The government also failed to introduce the ethical code of conduct as they had pledged.

### *3. The transnational justice mechanism and the building of a lasting reconciliation: The implementation of the UNHRC 30/1 resolution*

In October 2015, Sri Lanka co-sponsored a UN Human Rights Council (UNHRC) resolution (the 30/1 resolution), which called for a special judicial mechanism to prosecute war crimes and usher in an environment conducive to reconciliation. The Sri Lankan government promised the implementation of the measures required by the resolution. In particular, the government planned to create four transitional justice mechanisms: a Commission for Truth, Justice, Reconciliation and Non-recurrence; a judicial body with an Office of Special Counsel; an Office of Missing Persons; and an Office of Reparations.

On a more practical level, the only measure that the government was able to achieve was the creation of the Office of Missing Persons (OMP). This new office was empowered to search and trace missing individuals, clarify the circumstances of enforced disappearances, and identify ways to provide redress. In this case the government was rather quick to act. Although criticized for lacking of transparency and not engaging in public consultations with civil society, on 24 May 2016 Sri Lanka's cabinet approved the OMP Bill.<sup>16</sup> On 11 August 2016 the OMP Bill was definitively approved in Parliament. The Office was constituted at the highest level by the President, on recommendation from the Constitutional Council, and was composed of commissioners and officers supposed to be of the highest moral integrity. At the same time, Sri Lanka ratified the International Convention for the Protection of All Persons from Enforced Disappearance (ICPPED) (25 May 2016). Moreover, other confidence-building-measures were successfully implemented. These included the release of 701 acres of land to the District Secretary of Jaffna by the military.<sup>17</sup>

However, other measures aimed at the implementation of the UN Resolution encountered severe difficulties. The Reconciliation Mechanism

15. Lacille De Silva, 'National Audit Bill: Should they hold it up?', *The Island*, 24 July 2016.

16. 'Sri Lanka: Consultations Lacking on Missing Persons' Office', *Human Right Watch*, 27 May 2016.

17. Wimalanath Weerarathne, 'Right Moment for A Political Solution for the North', *The Sunday Leader*, 5 June 2016.

was a more controversial issue. The government established a task force on public consultations in order to obtain the public's opinion on the shape to give to the reconciliation mechanisms. The Task Force was an 11-member body of civil society activists and human rights defenders.<sup>18</sup> Launched in January, it was expected to start its activities in early April and to issue its final report by late September. After an abeyance of activity of several months, the Consultation Task Force started its activities only in June. On the whole they remained opaque and, at the end of 2016, the report had not yet been submitted. Furthermore, the government did not create the special court for war crimes. The delay was caused by the controversial issue of the participation of non Sri Lankan judges in the court. The idea of foreign participation in the accountability process has been resisted by Sinhala and other nationalist groups. The situation became more critical when President Sirisena declared to the BBC that he would not agree to foreign judges being part of the accountability process.<sup>19</sup> Later, PM Wickremesinghe clarified that President Sirisena did not rule out international involvement and also offered assurances that the government would stand by its commitment to the U.N. 30/1 resolution of October 2015. In the end a compromise was found, entailing the involvement of former Sri Lankan judges who had served in international bodies.<sup>20</sup> However the preceding lack of clarity and contradictions shown by the Sri Lanka government caused confusion in the international community. As has been highlighted, the government's reluctance to set up a credible domestic inquiry on war crimes suggested its intention was to postpone the establishment of the promised war crimes court until after March 2017 – when the U.N. High Commissioner will issue his final report on Lankan implementation of the 30/1 resolution.<sup>21</sup> The stalling of the government's momentum on some measures required by the U.N. resolution was also recognized by the High Commissioner for Human Rights, Zeid Ra'ad Al Hussein, in his preliminary report on the implementation progress of the 31/1 resolution, presented on 29 June. As highlighted by some observers, three grey areas remained: 1) a dearth of systematic public consultations; 2) obstacles in the OMP for aggrieved citizens to seek justice; 3) the rejection of the inclusion of foreign judges and prosecutors in the judicial mechanisms.<sup>22</sup>

18. T. Ramakrishnan, 'Reconciliation: Colombo set to launch consultations', *The Hindu*, 23 March 2016.

19. Easwaran Rutnam, 'Zeid to Seek Clarity on Role of Foreign Judges', *The Sunday Leader*, 31 January, 2016.

20. 'Col. R. Hariharan Judicial Investigation of War Crimes', *The Sunday Leader*, 8 February 2016.

21. Alan Keenan, 'Impunity and Justice: Why the UN Human Rights Council Must Stay Engaged in Sri Lanka', *International Crisis Group*, 17 June 2016.

22. J.S. Tissainayagam, 'Sri Lanka: Broken promises again at the UN?', *Asian Correspondent*, 21 June 2016.

#### 4. *Is there still a struggle for leadership within the SLFP?*

The year under review witnessed the continuation of the factional struggle within the SLFP.<sup>23</sup> This was essentially a struggle for the party leadership between Sirisena and Rajapaksa. At least at the beginning of the year, the tone of confrontation was kept low. Sirisena made drastic changes in the SLFP's institutional posts, which had previously been dominated by Rajapaksa loyalists. His aim was to unite all factions of party, and to gain the support of the former President's loyalists.<sup>24</sup> For his part, Rajapaksa – backed by his supporters within the SLFP and its allies in the United People's Freedom Alliance (UPFA)<sup>25</sup> – formed a *Joint Opposition* in Parliament and continued to actively oppose Sirisena's attempt at gaining the full control of the party.

A rise in tensions was clear when Rajapaksa organized the UPFA rebel group's May Day rally at Kirulapone, against the official SLFP May Day rally at Galle. This led the SLFP to be on the verge of a major split. Forty-seven MPs representing the UPFA attended the Rajapaksa's Joint Opposition May Day rally at Galle, and forty of them belonged to the SLFP.<sup>26</sup> However, during the Galle rally Rajapaksa maintained a conciliatory tone. He claimed that he did not intend to divide the party and was there as a member of the SLFP: «We have a rally in Galle too. Some of our MPs went to the Galle rally. They said they would go to the Galle rally first and then come to Kirulapone».<sup>27</sup> The SLFP also maintained a conciliatory tone, and the Party did not take any disciplinary actions against the participants in the Kirulapone event. However, two other events raised tensions. On 7 July, the Joint Opposition unveiled the formation of a 50-member shadow Cabinet led by Rajapaksa. In addition, a five-day-long protest march organized by the Joint Opposition took place near Kandy in August.<sup>28</sup> This latter event caused considerable concern, as it turned violent. In this situation, the Prime Minister and his UNP came to President Sirisena's rescue. In particular, the government tried to counter and to stop the protest march and delayed the holding of the local government elections.<sup>29</sup> For his part, Sirisena adopted drastic measures to restore party discipline and to consolidate his influence

23. Danila Berloff, 'Sri Lanka 2015: The Dawning of a new Era', pp. 421–22.

24. 'Sirisena isolating Rajapaksa, also brings UPFA under his fold', *The Sunday Times*, 13 March 2016.

25. As noted above, UPFA is a political alliance formed by several parties and lead by the SLFP.

26. 'SLFP decision-making bodies lose control over members: Forty MPs at Kirulapone rally', *Sunday Observer*, 08 May 2016.

27. *Ibid.*

28. T. Ramkrishnan, 'Pro-Rajapaksa coalition launches «March to Colombo»', *The Hindu*, 28 July 2016.

29. Uditha Kumarasinghe, 'Political parties at daggers drawn', *Sunday Observer*, 10 July 2016.

over the party: nine Rajapaksa loyalists were expelled from the SLFP and new electoral and district organizers were appointed.<sup>30</sup> Moreover, Sirisena threatened to further expose the «misdeeds» of his predecessor if Rajapaksa went ahead and further tried to split the party.<sup>31</sup> At the same time, Sirisena maintained a conciliatory approach towards dissidents within his own party. This was clear at the 65th anniversary rally of SLFP in Kurunegala on 4 September, when Sirisena offered an olive branch to rebels within the party, appealing to them to unite with the majority.<sup>32</sup> For its part, the pro-Rajapaksa faction urged its leader to break away from Sirisena and create a new party. However, no new party emerged, while the Joint Opposition continued to play its own role in Parliament. On 8 October, the Rajapaksa SLFP faction officially declared the birth of a Common Front in Parliament, made up of the opposition political parties and headed by the Joint Opposition. However, the SLFP split does not appear to be final, as unofficial discussions between its two factions appears to be on-going.

##### *5. Foreign Policy: The improved relationships with Washington and New Delhi*

The remarkable change of government that occurred in Sri Lanka in 2015 notably affected the island-state's international relations. During 2015, this was reflected in the new closeness between Colombo and both New Delhi and Washington and in the consequent cooling down of the relations with Beijing.

In 2016, the Sri Lanka's foreign policy vision – adopted the previous year by the Sirisena administration – continued to inform Colombo's policy and found expression in the willingness to maintain and consolidate equal relations and close engagement with both western countries and Asian neighbours. In particular, the upgrading and deepening of Sri Lanka's relations with both the US and India continued. In relation to the US, the continuing improvement in bilateral relations was signalled by the opening of the first «U.S.–Sri Lanka Partnership Dialogue», during the Sri Lankan Foreign Minister Mangala Samaraweera's visit to Washington in February.<sup>33</sup> The main goal of the «U.S.–Sri Lanka Partnership Dialogue» was to enhance the bilateral relations and consolidate the economic cooperation between

30. 'Sirisena purges SLFP of Rajapaksa loyalists', *The Hindu*, 17 August 2016.

31. 'Will expose Mahinda Rajapaksa «secrets» if he forms new party: Maithripala Sirisena', *The Indian Express*, 19 August 2016.

32. 'President Sirisena changes approach and holds out hand to dissidents', *The Sunday Times*, 11 September 2016.

33. Lisa Curtis 'Sri Lanka's Democratic Transition: A New Era for the U.S.–Sri Lanka Relationship', *Heritage.org*, 9 June 2016.

the two countries through a «regular and structured engagement».<sup>34</sup> The Dialogue also aimed «at strengthening accountable and responsive governance institutions and capacity building; training and assistance for enhancing accountability, transparency, integrity and effectiveness of public administration; and inclusive and effective service delivery including local governance».<sup>35</sup> The Joint Statement also declared Sri Lanka to be a «pivotal geo-strategic location within the Indian Ocean Region» and called for strengthening maritime security cooperation.<sup>36</sup> This event was followed by the 12<sup>th</sup> U.S.-Sri Lanka Trade and Investment Framework (TIFA) Council meeting held in April. During this meeting, the two governments adopted the «U.S.-Sri Lanka Joint Action Plan» aimed at significantly increasing two-way trade and investments between the two countries. This goal was to be implemented by the adoption of the joint policies and measures incorporated in the plan. These measures aimed at reforming Sri Lanka's trade and investment regime, improving the competitiveness of Sri Lanka's market, increasing the interaction between the US and Sri Lankan business communities, strengthening workers' rights, and promoting an environmentally sustainable economy in Sri Lanka.<sup>37</sup> As a further sign of warming relations between Sri Lanka and the US was the US Navy's Seventh Fleet Flagship arrival in Colombo for a five-day visit. Far from being a merely symbolic gesture signalling the friendship between the two nations, the ship's visit epitomized the close integration of Sri Lanka into the Obama administration's «pivot to Asia».<sup>38</sup> A few months later the State Department's Directorate of Defence Trade Controls (DDTC) announced the end of restrictions on defence exports to Sri Lanka (May 2016).<sup>39</sup>

Likewise, the reconciliation process between Sri Lanka and India continued as well. In February, the Indian External Affairs minister Sushma Swaraj met Sri Lankan leaders during her two-day official visit to Colombo (her second visit to the country within a year). Regional and international issues were addressed during the meeting; they included trade, defence cooperation, Indian investment in Sri Lanka, the setting up of a Special Economic Zone in Trincomalee, and technical and maritime cooperation.<sup>40</sup>

34. U.S. Department of State, *Joint Statement from the U.S. Department of State and the Ministry of Foreign Affairs of Sri Lanka on the Inaugural U.S.-Sri Lanka Partnership Dialogue*, 29 February 2016.

35. *Ibid.*

36. *Ibid.*

37. Office of the United States Trade Representative, *Joint Statement on the 12th Joint U.S.-Sri Lanka Trade and Investment Framework Council Meeting*, April 2016.

38. Vijith Samarasinghe 'US seeks to develop close military ties with Sri Lanka', *World Socialist Web Site*, 8 April 2016.

39. Jon Grevatt, 'Update: US Eases Military Trade Restrictions on Sri Lanka', *IHS Jane's 360*, May 9, 2016.

40. 'Sushma Swaraj, Sri Lanka PM Wickremesinghe hold talks on investment, SEZ', *The Economic Times*, 5 February 2016.

The two countries agreed to fast-track negotiations for an Economic and Technology Cooperation Agreement (ETCA).

Many Lankan leaders and political forces campaigned against the Agreement.<sup>41</sup> Although, at the end of the period under review the treaty has not yet been signed, the talks have produced some initial results: these include expanded Sri Lankan access to India's rapidly growing market; the relaxation of quotas on Sri Lankan exports to the Indian market; the removal of restrictions on exports of textiles from Sri Lanka to India.<sup>42</sup>

President Sirisena visited India on 13 May 2016. This was Sirisena's second state visit to India in 17 months. Both sides sought a permanent solution to some contentious issues, such as the issues concerning the fishermen of both countries.<sup>43</sup> On that occasion, Sirisena also attended – with leaders from other South Asian countries – the Simhastha Kumbh Mela, in Ujjain (Madhya Pradesh) on 14 May.<sup>44</sup> The meeting was used by Indian PM Narendra Modi to strengthen the relation between India and some Asian neighbours: a case of «cultural diplomacy» as means of foreign policy.<sup>45</sup> The strengthening of Sri Lanka-India relations took place also at the military level; partly through the opening of an Indian military training mission in Colombo, and the visit to Sri Lanka of Vice Admiral Girish Luthra, head of the Southern Command of the Indian Navy (in April 2016).<sup>46</sup>

#### *6. Foreign policy: Heading back into Beijing's embrace*

During the year under review, the closeness in the Colombo-Washington and Colombo-New Delhi relations did not prevent a rapprochement between Colombo and Beijing. As noted in the previous Asia Maior volume, after Sirisena's rise to the Presidency, the Sri Lanka-China relations, which had flourished during Rajapaksa's rule, came under scrutiny and took a sudden turn for the worse.<sup>47</sup> In 2016, however, the Sri Lankan government

41. For example, Thibbatuwawe Sri Sumangala Maha Nayaka Thero, the highest-ranking Buddhist prelate in the country. Gamini Weerakoon, 'The Demagogue and the Mahanayake', *The Sunday Leader*, 18 September 2016.

42. 'ETCA talks: early gains: Freed up exports to India', *Sunday Observer*, 21 August 2016.

43. The issue concerns the frequent arrests of fishermen of both countries and seizures of their fishing vessels by the Sri Lankan and Indian authorities in sea area between the two countries. Gautam Sen, 'Problem of Fishermen in India-Sri Lanka Relations', *Institute for Defense Studies and Analysis – IDSA*, 20 May 2016.

44. The Simhastha Kumbh Mela is a Hindu religious meeting held every 12 years in the Ujjain city of Madhya Pradesh, India.

45. Sreeram Chaulia, 'Cultural diplomacy', *The Asian Age*, 16 May 2016.

46. 'Navy woos Sri Lanka to check Chinese influence', *The Hindu*, 16 April 2016.

47. Danila Berloff, 'Sri Lanka 2015: The Dawning of a new Era', pp. 433–34.

shifted its approach to China once again, causing a marked improvement in the relations between the two countries.

A sign of the new positive shift in Colombo's approach to Beijing was the Unity Government's declaration that Sri Lanka would approve the resumption of the Chinese-backed Colombo Port City (CPC) Development Project (March 2016).<sup>48</sup> This declaration was followed by PM Wickremesinghe's visit to China in April. It was the first visit to China by a Sri Lankan Prime Minister. The two countries reaffirmed their enduring ties, decided to resume stalled projects and planned the launching of new projects. Moreover, China pledged a friendly grant to and more investments in the island nation; the penalty for suspending the CPC development project was renegotiated; seven agreements were signed; in the end the two countries agreed on an «equity swap»<sup>49</sup> for the Lankan debt with China.<sup>50</sup>

In July 2016, Chinese Foreign Minister Wang Yi visited Colombo. It was the first major visit by a Chinese leader since the start of Sirisena's presidency in 2015. Yi promised that the Chinese government would continue to assist the South Asian island-nation's development. He also made a pitch for Sri Lanka's support for the «21st Century Maritime Silk Road», assuring that: «Through joint construction of the Maritime Silk Road, China is willing to help Sri Lanka realize its development vision and help it become the future shipping, logistics and even financial center in the Indian Ocean».<sup>51</sup> Moreover, the two sides also agreed to start talks on a free trade agreement. In August an agreement was signed, which re-started the Chinese-funded CPC project.<sup>52</sup> Also, Colombo showed interest in the signing of military agreements with Beijing, in particular to replace the Sri Lankan Air Force's ageing fleet.<sup>53</sup>

48. Sarah Watson, 'Colombo Port City and the Limits of India's Regional Diplomacy', *Asian Maritime Transparency Initiative*, 11 April 2016.

49. Equity Swap (also known as debt-for-equity-swap or debt-equity swap) is «a system by which firms or countries with excessive debt exchange part of their debt obligations for equity, held initially by the former creditors». John Black, Nigar Hashimzade, & Gareth Myles, *Oxford Dictionary of Economics*, Oxford: Oxford University Press, 2012, p. 100. In April 2016, the Sri Lankan government asked China to swap part of the island-country's debts for equity (or shares) in infrastructure projects and to sell stakes in Lankan companies to Chinese corporations. Ben Blanchard, 'Sri Lanka requests equity swap for some of its \$8 bln China debt', *Reuters*, 9 April 2016.

50. 'Shihar Aneez & Ranga Sirilal, 'Sri Lanka to negotiate \$125 mln Chinese firm seeks for port delay', *Reuters*, 6 April 2016; Ben Blanchard, 'Sri Lanka requests equity swap for some of its \$8 bln China debt'; 'Economic strategies between Sri Lanka and China finalized', *Sunday Observer*, 10 April 2016.

51. Munza Mushtaq 'Wang Yi's visit boosts China-Sri Lanka ties, sparks concern in India', *Asia Times*, 18 July 2016.

52. Munza Mushtaq, 'China to promote Sri Lankan capital as South Asian hub', *Asia Times*, 22 August 2016.

53. 'China launches drive to overcome dependence on Russian jet engines', *The Statesman*, 4 September 2016.

### 7. *The trend of the economic situation and the 2016 mini-budget*

At the beginning of 2016, the economic situation seemed to be positive and promising. In the first half of the year, Sri Lanka witnessed a growth rate of the Gross Domestic Product (GDP) equal to 5.5% (much higher than the 2.5% growth rate in the fourth quarter of 2015). This positive rate of growth was achieved owing to increased production in all sectors.<sup>54</sup> Furthermore Sri Lanka's budget deficit narrowed to 18% when compared to the previous year.<sup>55</sup> These promising developments encouraged the Sri Lankan government to expect an economic growth of 7% by the end of 2016 and the continuation of the industrial growth momentum. Also, it expected enhanced investments from the major Asian economies<sup>56</sup> and that a boom in the tourist industry would further boost the economy.<sup>57</sup>

However, these rosy expectations did not materialize: the Sri Lankan economic situation continued to be weak and uncertain. A combination of heavy debt, widening deficits in both the government budget and balance of payments, the diminution of foreign currency reserves, the limited number of investors, and a rickety tax system were the causes of the fragility of the Lankan economy.<sup>58</sup> Not surprisingly, concerns about the economic situation were expressed by the International Monetary Fund (IMF). During its official visit to the Sri Lanka in February, IMF officials warned that the fiscal deficit could widen further and that: «capital outflows have intensified and the overall balance of payments has deteriorated».<sup>59</sup> IMF urged Sri Lanka to take steps to reduce its fiscal deficit, to raise tax revenues and to put the country's public finances on a sustainable path. Other similar exhortations came from the Asian

54. Agricultural growth was the slowest at a modest 1.9% owing to adverse weather conditions and depressed prices for tea. There was a substantial increase of 8.3% in the industrial sector in the first quarter of 2016, compared to 1.4% in the first quarter of 2015. Services that contributed 52.4% to GDP grew at 4.9% in the first quarter of 2016 compared to the first quarter of 2015. 'What's happening to the real economy this year?', *The Sunday Times*, 24 July 2016.

55. 'Sri Lanka budget gap down in first half 2016, on target', *EconomyNext*, 12 September 2016.

56. As part of its efforts to attract foreign investment, Sri Lanka hosted the 2016 Sri Lanka Economic Forum in January 2016. Saman Gunadasa 'Sri Lankan government tries to woo foreign investors', *World Socialist Web Site*, 20 January 2016.

57. 'Sri Lanka's return to glory', *The Telegraph*, 8 June 2016.

58. 'Taxing times. The island turns to the IMF despite strong growth', *The Economist*, 13 February 2016; 'SL economy in distress with debts and deficits, corrective policies yet to come', *The Sunday Times*, 13 March 2016.

59. 'IMF asks Sri Lanka to reduce budget deficit, improve funds', *Business Standard*, 6 February 2016.

Development Bank (ADB).<sup>60</sup> Against this backdrop, Standard and Poor downgraded Sri Lanka's economic outlook.<sup>61</sup>

In March, the Sri Lankan government presented a «2016 Mini Budget» aimed at amending the 2016 Budget.<sup>62</sup> The proposal sought to revise the existing pension scheme and the tax structure, introducing new taxes.<sup>63</sup> However, the proposal went nowhere, as a result of two Supreme Court rulings.<sup>64</sup> In this difficult situation, Sri Lanka started talks with the IMF concerning the introduction of neoliberal economic reforms in return for a bailout loan. An agreement between the IMF and the Sri Lankan government was reached in April: IMF agreed to a US\$ 1.5 billion loan and Sri Lanka pledged to implement structural economic reforms, which included measures aimed at increasing tax revenues, reducing the fiscal deficit and the public debt, and improving foreign exchange reserves.<sup>65</sup> In June, the IMF executive board formally approved a US\$ 1.5 billion loan to Sri Lanka. A first tranche, equal to US\$ 168 million, was immediately disbursed.<sup>66</sup> In August, the World Bank also approved a US\$ 100 million credit line from the International Development Association (IDA) to support Sri Lanka's economic reforms.<sup>67</sup>

During the second half of the year, Sri Lanka witnessed a clear worsening of its economic conditions. The expansion of Sri Lanka's economy was below (2.6%) the increase recorded in first quarter (5.5%). Moreover, the debt crisis worsened in comparison with the first half of year. Sri Lanka's balance of payments deteriorated and its foreign debt tripled.<sup>68</sup> Sri Lanka's fiscal deficit goal for 2016 appeared difficult to reach.<sup>69</sup> Hidden debts left by the previous Sri Lankan government aggravated the economic situation;<sup>70</sup>

60. Asian Development Bank, *ADB President Announces Scaled-Up Support for Sri Lanka to Over \$2 Billion for 2016–2018*, 23 February 2016.

61. 'S&P downgrades Sri Lanka rating outlook to negative', *EconomyNext*, 10 March 2016.

62. In Sri Lanka, the financial year coincides with the solar year. Accordingly, the 2016 budget covers the solar year 2016.

63. 'Emergency Budget: Cabinet approves sweeping tax reforms', *The Sunday Times*, 6 March 2016;

64. 'Sri Lanka court suspends government's tax hikes', *Reuters*, 11 July 2016.

65. Saman Gunadasa 'IMF attaches harsh austerity measures to Sri Lankan bailout', *World Socialist Web Site*, 16 April 2016.

66. 'International Monetary Fund approves \$1.5 billion loan to Sri Lanka', *Business Standard*, 4 July 2016.

67. 'World Bank gives \$100 million for Sri Lanka's economic reforms', *Business Standard*, 1 August 2016.

68. 'Sri Lanka's Credit Crunch. The island is paying a steep price for a turn against democracy', *The Wall Street Journal*, 30 May 2016.

69. 'Sri Lanka's 2016 fiscal deficit goal challenging despite H1 success – economists', *Reuters*, 13 September 2016.

70. 'Sri Lanka's PM says financial crisis aggravated by hidden debt', *Reuters*, 11 August 2016.

the flow of remittances diminished;<sup>71</sup> the government could count on very limited fiscal revenues as a result of the non-implementation of the fiscal reforms of the 2016 «mini budget». The economic situation was further aggravated by the unfavourable meteorological conditions: in May a deadly cyclone hammered the South Asia region, and Sri Lanka was particularly affected.<sup>72</sup> Moreover Sri Lanka's economy was put under further pressure by a scandal involving the Central Bank Governor, which undermined the Sri Lankan economic system's credibility.<sup>73</sup>

#### 8. *Accelerating growth with social inclusion: The 2017 budget*

The Budget for the fiscal year of 2017 was presented to Parliament on 10 November 2016.<sup>74</sup> Presenting the budget, the Finance Minister, Ravindra Sandresh Karunanayake, claimed that, in it, priority was given to the people's proposals, needs and views. He argued that the Budget making process had mainly been focused on developing a long-term action plan to fulfil aspirations of all citizens, to strengthen the national economy and to develop a tangible initiative against poverty.<sup>75</sup> This was the theory; in reality the objectives of the 2017 Budget were somewhat – even if not totally – different and coincided with three targets: reducing both the budget deficit and expenditures; increasing state revenue; fighting poverty and increasing social welfare.

Speaking in Parliament, Karunanayake claimed that budget deficit reduction and fiscal consolidation were pivotal goals in the government's strategy.<sup>76</sup> He stated that «[...] it is critical that the fiscal deficit is reduced to a reasonably sustainable level. All efforts should be made to reduce and contain pressures on escalating inflation and interest rates as well as exchange

71. This is dangerous for a remittance-dependent economy such as Sri Lanka. No doubt the balance of payments would be in a far more serious crisis without remittances. 'Economy's continued dependence on remittances', *The Sunday Times*, 18 September 2016.

72. 'Sri Lanka floods expected to cost at least \$1.5 billion', *Reuters*, 23 May 2016.

73. The Central Bank Governor, Arjuna Mahendran, was accused of leaking information to his son-in-law's firm (which allegedly made millions of dollars in profits from central bank bond auctions). He was replaced by Indrajit Coomaraswamy. Ranga Sirilal & Shihar Aneez 'Sri Lanka appoints ex-central banker Coomaraswamy as new c.bank chief', *Reuters*, 2 July 2016.

74. This was the second budget of the National Unity Government. The full text of the budget presentation speech (in PDF) is available at the Sri Lankan Ministry of Finance's official web site (<http://www.treasury.gov.lk/budget-speeches>).

75. *Budget Speech-2017, Speech of Ravi Karunanayake, Minister of Finance, 10 November 2016* [hereafter *Budget Speech-2017*], pp. 1-3.

76. Charumini de Silva, '2017 Budget proposals and issues under spotlight at KPMG forum', *DailyFT*, 15 November 2016.

rate depreciation through macroeconomic stabilization». <sup>77</sup> The government aimed for 6% economic growth, <sup>78</sup> and planned to reduce the budget deficit to 4.6% of GDP. <sup>79</sup> According to the government's plan, the budget would be further tightened and the budget deficit target would be brought down to 3% by 2020 (from the previous target of 3.5%). <sup>80</sup> Moreover the total expenditures would be reduced from Rs 2,787 billion to Rs 2,723 billion in 2017 (with a decline of about Rs 64 billion). <sup>81</sup> On the development and investments front, the government aimed to maintain state investments of between 6 and 8% of the GDP. The Minister promised that the government would intervene to facilitate more investments from the private sector. <sup>82</sup> The Finance Minister also promised the creation of an Agency for Development to: «[...] enable an enhanced facilitation of investments to Sri Lanka» <sup>83</sup> as well as the introduction of an Investment Inflow Management Act: «[...] to facilitate the inward remittance of foreign exchange with minimal restrictions». <sup>84</sup> To boost Foreign Direct investment (FDI), Karunanayake promised the provision of both a grant and a special incentive package with specific tax concessions for domestic and foreign companies which invested in Sri Lanka. <sup>85</sup>

Increasing the government's revenues was another main goal of the 2017 budget, to be reached thanks to an increase in direct taxation. <sup>86</sup> The government aimed to revise the income tax system to pave the way for a simpler income tax regime with fewer tax exemptions. <sup>87</sup> Moreover, the corporate income tax rate was to be revised (creating a three tiered structure of 14%, 28% and 40%; and the tax rate on funds, dividends, treasury bills and bonds was to be increased to 14% from 10%). <sup>88</sup> The personal income tax rate was to be revised: the structure of individual taxable income levels was to be modified and the maximum rate was to be fixed at 24%. <sup>89</sup> Furthermore, a 10% Capital Gains Tax (CGT) was introduced. <sup>90</sup>

77. *Budget Speech-2017*, p.5.

78. *Ibid.*, p. 130.

79. *Ibid.*, p. 108.

80. *Ibid.*, p. 123. The previous target had been indicated by Prime Minister Wickremesinghe in his speech to Parliament in November 2015 and officially reaffirmed by Finance Minister Karunanayake during his meeting with the IMF envoys in September 2016.

81. Rathindra Kuruwita & Umesh Moramudali, 'Budget 2017 is elitist-Ahilan Kadiragamer', *Sri Lanka Brief*, 21 November 2016.

82. *Budget Speech-2017* p. 35.

83. *Ibid.* § 172, p. 35.

84. *Ibid.* § 181, p. 37.

85. *Ibid.* § 175 and § 176, p. 36.

86. *Ibid.* § 443, p. 83.

87. *Ibid.* § 446, p. 83.

88. *Ibid.* § 447, p. 83.

89. *Ibid.* § 452, p. 84.

90. *Ibid.* § 481, p. 88.

On the social and welfare front, the struggle against poverty and social exclusion was a significant element of the budget. Karunanayake declared that «[...] Social inclusion is a matter of prime concern and the participation of the entire population in the journey for development is a noble objective being ‘a society for all’. Accordingly, **“Accelerating Growth with Social Inclusion”** forms the broader theme of the 2017 National Budget». <sup>91</sup> For this reason, the government planned to supplement low incomes through several state-implemented household transfer schemes, and the implementation of a more effective, targeted and expanded social welfare scheme. <sup>92</sup> The government also planned to revise the pension scheme system. <sup>93</sup> Furthermore, the maximum retail price of some essential commodities was reduced in order to diminish the cost of living. <sup>94</sup> Subsidies in specific productive sectors were extended. <sup>95</sup> A home ownership program for low- and middle-income families was announced. <sup>96</sup> Large and pragmatic plans for investments in the education, higher education and skills development sectors were also announced. <sup>97</sup> Moreover the Finance Minister also pointed out that welfare spending would be increased by 55% to Rs 403 billion (an increase of Rs 143 billion when compared with Rs 260 billion allocated in 2014, the final year of the former government). <sup>98</sup>

The budget has been criticized by some analysts and political parties, which have claimed that it was «elitist» and «created by the elites for the elites» in order to implement austerity measures. <sup>99</sup> However, a more balanced assessment seems to be that, as was the case with the 2016 budget, the 2017 budget also appears to be «a complex effort, aimed at bringing together measures which could encourage both domestic and international capital to invest in the Sri Lankan economy, while introducing a conspicuous set of measures in support of the poorer and intermediate strata of the population». <sup>100</sup>

91. *Ibid.* § 9, and §10, p. 3 (the inverted commas and bold type are given as in the original).

92. *Ibid.* § 318, § 319, § 320, p. 61.

93. *Ibid.* § 323, p. 62.

94. *Ibid.* § 439, p. 80.

95. ‘Budget 2017: Govt has increased welfare spending – Ravi K.’, *Sunday Observer*, 27 November 2016.

96. *Budget Speech-2017*, § 300 and § 307, p. 58–59.

97. *Ibid.* p. 19–25.

98. ‘Budget 2017: Govt has increased welfare spending – Ravi K.’.

99. Rathindra Kuruwita & Umesh Moramudali, ‘Budget 2017 is elitist-Ahilan Kadiragamer’; Nimal Sanderatne ‘Budget 2017: Critical assessments, plaudits and ideological prejudices’, *The Sunday Times*, 27 November 2016.

100. Danila Berloff, ‘Sri Lanka 2015: The Dawning of a new Era’, p. 446.