

# India's relations with Sri Lanka

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## Introduction

Since a low point in 1990 when the Indian Peace-Keeping Forces (IPKF) withdrew from Sri Lanka, the relationship between India and Sri Lanka has undergone a period of significant recuperation. In the late 1980s and early 1990s the bilateral relationship suffered from bitterness and mistrust on both sides. Today the relationship is much healthier, and the two countries maintain close economic and defence co-operation. How did this positive transformation in their relationship occur, and what challenges and issues constrain the development of an even stronger bilateral relationship?

India's economic-led foreign policy, exemplified in the Manmohan Doctrine, found a way to foster a close relationship with its neighbour. India emphasized economic relations and backed away from the highly contentious political issues of conflict intervention. Since the India-Sri Lanka Free Trade Agreement (ISLFTA) became operational in 2000, increased trade and investment have been the impetus for the improvement in bilateral relations.

India's decision to offer Sri Lanka favourable terms in a free trade agreement yielded not only greater economic engagement, but political and strategic benefits as well. A significant reduction in the trade balance, which had been heavily lopsided toward India, helped diminish the Sri Lankan perception of India as the region's hegemonic bully. Burgeoning trade and investment between India and Sri Lanka, including in the strategic energy sector, have woven economic inter-dependency into the bilateral relationship. This helped India and Sri Lanka push past the mistrust and resentment that had characterized the deterioration in their relationship during the late 1980s and early 1990s.

This chapter begins with a look at India's strategic interests in Sri Lanka to understand the motivations driving India's behaviour. It then gives a brief historical account of India's Sri Lanka policy from the beginning of the conflict in 1983 until the IPKF withdrew in 1990. After the historical section, the chapter examines the central dilemma in India's policy stemming from the political compulsions of its Tamil Nadu constituency. The chapter then turns to defence relations followed by a look at how economic engagement spurred the positive turn-around in the relationship. The chapter ends by addressing India's concerns about Chinese influence in Sri Lanka.

## India's strategic interests in Sri Lanka

After the Cold War India's interests in Sri Lanka shifted from geostrategic power balancing to pragmatic security considerations. During the 1980s and early 1990s India's strategy to avoid the Cold War power struggle eclipsed efforts to support Sri Lanka's peace and stability. In the post-Cold War period, however, India's economic and pragmatic security interests led it to emphasize Sri Lanka's peace and security in an effort to control the externalities of the conflict threatening to undermine India's own security and internal stability. Thus, today, Sri Lanka's unity, peace and stability are India's primary concern. Additionally, maritime security in the Indian Ocean and between India and Sri Lanka has developed into a prominent concern for Indian policy-makers. Sri Lanka is located at an important point for projecting naval power into the Indian Ocean, and is an enviable berth for major naval powers with interests in the region. Within this, the influence of the People's Republic of China and Pakistan in Sri Lanka is also worrisome for India's security interests.

During the Cold War India pursued a policy of non-alignment, intended to guide Cold War geostrategic struggles away from its borders. While this was not possible along India's northern borders, near its southern border Indian policy-makers saw an opening in Sri Lanka to expel the troubling US encroachment. With the terms of the 1987 Indo-Sri Lankan Accord (ISLA), India sought to gain Sri Lanka's allegiance as a way to eliminate the USA's strategic presence in Sri Lanka, considerations reflecting the Indira Doctrine notion of India's regional pre-eminence. Under the ISLA, Sri Lanka had to scrap the American contract for the Trincomalee oil storage facilities, and remove the *Voice of America* outlet with which the USA broadcast radio messages into Soviet-friendly territory and transmitted intelligence reports. This geostrategic thinking reflected the Indian policy-makers' aim to push the USA's Cold War meddling a safe distance from India's borders.

The onset of the post-Cold War period diminished Sri Lanka's strategic importance in regional politics.<sup>1</sup> India's major strategic concern shifted to Sri Lanka's instability because of the effects it was having on India's own stability. Sri Lanka's decline of strategic importance to India reflected much stronger Indo-US relations. In the post-Cold War 1990s the USA accorded India a prominent place in American foreign policy initiatives in South Asia. Subsequently, Indo-US relations became highly developed and close. Instead of US encroachment, it has been negative externalities of the conflict that have irritated the relationship since the end of the Cold War.

Sri Lanka's ethnic violence increased maritime security concerns in the Palk Strait and adjacent water. India has a large economic stake in a secure and manoeuvrable Indian Ocean environment, and Sri Lanka plays a significant role in this. Sri Lanka occupies a critical location in the Indian Ocean's strategic environment, as international shipping lanes flow right by Sri Lanka's southern coast. The port of Colombo is used as an entry and exit point for regional goods, bound for or incoming from the East and the West. The Indian Ocean accommodates half the world's containerized freight, one-third of its bulk cargo, and two-thirds of its oil shipments.<sup>2</sup> Thus its security is an essential consideration for all economies with significant sea-based trade and energy demands.

India, especially, has important economic reasons for ensuring a stable security situation in and around the Indian Ocean. Sea trade dominates India's overall transnational trade, and nearly 89% of oil imports to India arrive by sea. Sri Lanka plays a particularly important role in India's maritime trade: over 70% of Indian imports arrive through the port of Colombo for bulk-breaking before they are shipped on local vessels to Indian ports. In the post-Cold War period, and especially since India passed trade-oriented economic reforms in 1991, India's dependence on the Indian Ocean as a maritime trading zone and transit-way for oil trade has meant that

securing the Indian Ocean is crucial to its continued engagement with the international marketplace. The waters adjacent to Sri Lanka assume special significance in these security arrangements.

Sri Lanka's strategic importance as a maritime power base in the Indian Ocean has historical roots. Sri Lanka's colonizers—the Portuguese, the Dutch and the British—recognized Sri Lanka's value as a trading port and naval base. The British occupied the island, then called Ceylon, not only for strategic maritime purposes (as the Portuguese and Dutch had done), but also for the protection of neighbouring British India. After independence India continued to recognize and treat Sri Lanka as strategically important in the regional maritime environment.

With strong motivations for major powers to gain economic and military access on the island, Sri Lanka finds itself vulnerable to major power penetration. In the 1980s the USA gained a listening post into the USSR from the island, irking Indian policy-makers. Since then, China's and Pakistan's engagement with Sri Lanka's defence and economic activity has worried Indian policy-makers. Foreign power penetration in Sri Lanka is inimical to Indian interests.

### **The 1980s: India meddles and then intervenes in Sri Lankan conflict**

In July 1983 an attack by the nascent Tamil militant group, the Liberation Tigers of Tamil Eelam (LTTE), provoked a violent backlash against Sri Lankan Tamils by the Sinhalese-dominated Sri Lankan state. Sombrely referred to as 'Black July', these events marked the beginning of full-scale ethnic conflict that would vitiate the next 25 years of Sri Lankan history. The conflict would also put a damper on relations with Sri Lanka's closest neighbour and regional power—India.

Two major influences pushed India's policy response to the Sri Lankan conflict: the active engagement of foreign influence by the Sri Lankan Government and the demands of India's own Tamil population for India to act on behalf of the Sri Lankan Tamils. Sri Lanka pushed for a military solution to the conflict by seeking external support from countries that India was not comfortable having a presence so close to its southern border. As the scholar S.D. Muni pointed out in his authoritative account of India's peace-keeping venture, Sri Lanka 'wanted to isolate India in the region by facilitating the strategic presence of the forces inimical to India's perceived security interests'.<sup>3</sup>

Also of concern to India was the backlash among kin Tamils in Tamil Nadu. India's Tamil population in Tamil Nadu, then some 50m.-strong, felt India had a responsibility to control the Sri Lankan state's harsh response against Sri Lankan Tamils. For India, the July 1983 events in Sri Lanka were alarming, and the Government of India, then under Prime Minister Indira Gandhi, asserted its influence on the situation as a regional power, kin state, and close neighbour.

Mrs Gandhi's policy featured a multi-pronged approach. She persuaded the Sri Lankan President Jayewardene to open negotiations with Tamil groups,<sup>4</sup> and India facilitated direct talks between the Sri Lankan Government and Tamil leadership (the Tamil United Liberation Front, not the LTTE), producing the Annexure 'C' proposals for the devolution of power. Even as she beckoned Jayewardene to dialogue with the Tamils, however, Indian government officials voiced strong concerns and sympathy for the sufferings of the Sri Lankan Tamils. For the Sri Lankan Sinhalese population, India's rhetorical support for the Tamils biased India's support for a negotiated settlement. By focusing attention in Western capitals on the Sri Lankan military's aggression towards the Tamils, India further fortified the Sinhalese perception that India was prejudiced against the Sri Lankan state.<sup>5</sup> It was also during this time that India's external intelligence agency, the Research and Analysis Wing (RAW), began supplying Tamil militant groups with military training, cash and arms in an attempt to draw them under India's influence

and to use that influence as leverage against the Sri Lankan state. RAW's support for the nascent Tamil militant groups gave them an important source of strength in their early days of violent resistance against the Sri Lankan state.

When Rajiv Gandhi succeeded his assassinated mother as Prime Minister, he changed tack on his mother's Sri Lanka policy. Rajiv drew closer to the Sri Lankan state and toughened India's position on the LTTE. He reversed his predecessor's policy on negotiations by adopting the Sri Lankan Government's position to hold negotiations only after, as opposed to before, cessation of violence. At this time as well, India, in co-operation with the Sri Lankan Navy, started patrolling the Palk Straits in earnest, to counter Tamil militant groups which were transporting supplies and rebels between the southern coast of India and northern Sri Lanka. The policy shift, under Rajiv, pushed for a resolution of the conflict at the cost of alienating the Tamil militants.

Rajiv's policy failed to end the conflict or resolve the ethnic issue. By the end of 1985 the Tamil militants had established international connections and received supplies and sanctuary in Tamil Nadu now without Indian intelligence covert support. To make matters worse, Colombo was showing no proclivity toward granting basic regional autonomy and devolution of powers to the Tamil community. After failed peace talks between the Sri Lankan Government and Tamil leaders in the Bhutanese capital, Thimphu in 1985, the Sri Lankan Government resumed its military solution against the Tamil insurgency. By 1987 the Tamils on the Jaffna Peninsula faced a humanitarian crisis caused by the Sri Lankan offensive, pushing India to intervene. After sending relief supplies by boat, which Sri Lanka turned away, India launched Operation Poomalai dropping 'bread bombs' (relief packages) on the Peninsula from Indian Air Force planes. Critics complained that India had impinged on Sri Lanka's sovereignty, but India was unapologetic since it held that its intervention had helped limit Tamil suffering at the hands of the Sri Lankan Government. Sri Lanka's military offensive had challenged India's tolerance for state violence against the Tamil population, and India responded with a more active policy.

Operation Poomalai served as the launching pad for deeper and formalized Indian intervention in Sri Lanka. In June 1987 Sri Lanka's Minister of External Affairs stated that by involving itself through the use of 'bread bombs', India now had a 'moral obligation' to resolve the ethnic dispute. The Minister's statement, while beckoning India's further involvement, also indicated India's loss of credibility as a mediator on the ethnic issue, as it made clear India's bias in favour of the Tamil cause.<sup>6</sup> Its humanitarian intervention did, in fact, signal India's openness to greater intervention, prompting Sri Lanka, then under President J.R. Jayewardene, to initiate talks with Rajiv Gandhi, resulting in the signing of the ISLA on 29 July 1987.

The ISLA was signed between India and Sri Lanka with only a dubious 'go-ahead' from the LTTE. When the ISLA was implemented, the lack of LTTE 'buy-in' to the agreement proved disastrous. Under the terms of the ISLA, the Sri Lankan Government agreed to make constitutional changes for devolving powers, the essential moderate Tamil demand, in exchange for India enforcing an arms collection from the rebel groups. India's obligation essentially made it the guarantor of peace. The LTTE briefly stopped fighting, but did not hand over its weapons, and soon resumed violent insurgency—this time against Indian troops. The provisions of the ISLA compelled the IPKF to engage the LTTE, which Indian intelligence had earlier helped train.

The IPKF transformed from a peace-keeping mission into a counter-insurgency campaign, which India was ill-equipped to fight on unfamiliar territory. The IPKF suffered failure and substantial casualties (over 1,200 fatalities), causing resentment and mistrust on all sides—India, Sri Lanka and the LTTE. There was a backlash in Sri Lanka to Indian troops on Sri Lankan soil, with the Sinhalese nationalist Janatha Vimukthi Peramuna launching a short-lived violent insurrection. Tamils in India resented India for turning its troops on Sri Lankan Tamils in what they saw as an unjust war against their ethnic kin population. Two years before the end of the

Cold War, in 1989, then Sri Lankan President Ranasinghe Premadasa started pushing for IPKF withdrawal from Sri Lanka, embarrassing India on the world stage. When power changed hands in Colombo and India, there was a consensus in India to withdrawal and the last IPKF soldiers returned to India in early 1990.

India's involvement in Sri Lanka's ethnic conflict transformed from heavy meddling, with both state and non-state actors, starting in 1983, to failed 'boots on the ground' intervention in the late 1980s. This pushed Indo-Sri Lankan relations to a new low. In 1991, after the IPKF withdrawal was complete and the LTTE had assassinated former Indian Prime Minister Rajiv Gandhi, India brought its involvement in Sri Lanka's internal ethnic conflict to a complete halt. After 1991 India reversed its policy of active involvement, distancing itself from an interventionist role that in the past it had felt compelled to play.

### **Tamil Nadu influence on India's policy**

The central dilemma in India's Sri Lanka policy since IPKF withdrawal was trying to balance the Sri Lankan Government's needs with the sensitivities of its own domestic Tamil population. This proved particularly difficult during the latter part of the protracted conflict in Sri Lanka when India could not supply the Sri Lankan military with its arms and munitions needs. To India's chagrin, Sri Lanka turned to China to supply its military. With the military defeat of the LTTE in May 2009, India can step now closer to the Sri Lankan state. However, it still must contend with encroachment of foreign powers through economic avenues of influence.

Tamil Nadu's political parties, to a significant degree, have the power to translate Tamil Nadu's sympathies for its kin population into Indian government policy. Over 60m. Tamils in Tamil Nadu have kin, community and cultural ties with the Tamil community in Sri Lanka. Tamil Nadu politicians, particularly in election years, take a 'stand' in support of Sri Lankan Tamils to play on the sympathies in its own Tamil population. Tamil Nadu's political representation in coalitions at the Centre, as is the case in the present coalition, gives it formidable influence on the Centre's policy. This means that India's policy decisions on matters involving Sri Lanka have to take into consideration Tamil Nadu's likely reactions to the effects such decisions may have on the Sri Lankan Tamil population.

Tamil Nadu's sympathies for the Tamil population in Sri Lanka remain a prominent aspect of India's Sri Lanka policy. In the 1980s organizations and political parties in Tamil Nadu sourced, trained and harboured Tamil militants fighting against the Sri Lankan state. After the IPKF experience and Rajiv Gandhi's assassination, public opinion of the LTTE throughout India dropped precipitously, including in Tamil Nadu. Ganguly writes, 'the little public sympathy which the LTTE enjoyed in Tamil Nadu was also eroded when it became clear that the LTTE was responsible for the assassination of Rajiv Gandhi'.<sup>7</sup> Still, Tamils in Tamil Nadu retain sympathy for their kin ethnic group in Sri Lanka.

The parties in Tamil Nadu take different positions on the LTTE and the Tamil cause. Jayaram Jayalitha's All-India Anna Dravida Munnetra Kazhagam (AIADMK) has been unequivocally against the LTTE in sharp contrast to the historical support of the Dravida Munnetra Kazhagam (DMK) political party. However, the DMK, under Chief Minister Karuninidhi, has grown colder in its support for the LTTE during its current phase of leadership in the state. Karuninidhi's previously supportive position especially came under challenge when the LTTE's relationship with south Indian fishermen soured following a rise in LTTE violence against the fishermen. The Marumalarchi Dravida Munnetra Kazhagam (MDMK) party and the Pattali Makkal Katchi (PMK) continue to run on platforms of support for the LTTE, championing the case of a Tamil Eelam—a separate homeland for Tamils in north-east Sri Lanka.

There are a few recurring issues in the Sri Lankan conflict that spark controversy and protests in Tamil Nadu. Chief among these issues is the refugee inflow from Sri Lanka into southern India. Today, over 100,000 Sri Lankan refugees who have escaped the violent ethnic conflict live in over 100 government-run camps in southern India, for the most part in Tamil Nadu. During peaks in violence, refugee flows to southern India rose dramatically, crowding camps and unofficial refugee communities. Often the inflow unsettled an already fragile political environment and frail economic situation in the south Indian state. Tamil Nadu's sympathies are also sensitive to any support given by India to the Sri Lankan military. Similarly, the proposed India-Sri Lanka Defence Co-operation Agreement, discussed below, has reportedly been held-up by political parties from Tamil Nadu.

### **'Hand's off' the conflict**

India's policy of simultaneously supporting a political solution to the conflict and tacitly condoning Sri Lanka's clampdown on LTTE terrorists allowed India to pragmatically respond to the LTTE terrorist threat and maintain a safe, albeit removed position from the conflict vis-à-vis support for the peace process. India's tacit support for Sri Lanka's defence measures against the LTTE, though far from whole-hearted, encouraged Sri Lankan military co-operation on threats to Indian security and ensured that the LTTE did not overpower Sri Lanka's state defences. As for support to the failed Norway-led peace process, Indian leaders were apprised of developments by reports of Sri Lankan government officials and other governments involved, particularly Norway, the United Kingdom and the USA. Its limited response to the developments, however, enabled it to keep a safe distance from the controversial political issues involved. Critics characterized India's policy as a 'do-nothing stance', arguing, alongside other observers, that India should move to a 'more active role' in facilitating discussions between the two sides.<sup>8</sup>

India's policy of simultaneously supporting Sri Lanka's 'unity and integrity' and a 'negotiated settlement' to the ethnic conflict, raises questions about where India stands. For instance, will the Indian Government resist pressures from its own Tamil Nadu constituency to intervene if Sri Lanka's Tamil populations face mass suffering? For the Indian Government, the two positions articulated as one—valuing Sri Lanka's 'unity and integrity' and pressing for a 'negotiated settlement'—allow for a flexible policy under which it can tailor responses to developments in Sri Lankan politics and the ethnic conflict. India's policy remains at times a frustrating balancing act between domestic political pressures from Tamil Nadu and pragmatic security concerns.

The Indian Government officially maintains that the ethnic conflict is a Sri Lankan problem that only Sri Lankans and their government can solve on their own. This Indian response was a knee-jerk reaction to the embittering IPKF experience, suggesting a parallel with the USA's 'Viet Nam syndrome'—that is since intervention did not work and came at a great cost, to prevent any chance of its re-occurrence one would go to the other extreme: 'hands-off'. India's 'hands-off' policy, though formulated through a political response to failed military intervention, has been sustained on account of its success in repairing relations with Sri Lanka and avoiding contentious loyalty issues surrounding the conflict. However, Sri Lanka's ethnic conflict continued to irritate relations with spill-over effects negatively impacting on India.

### **Defence relations**

India's defence relationship with Sri Lanka was minimal throughout the 1990s, and it continues to remain rather limited, despite Sri Lanka's proximity to India and their mutual security concerns. However, there are some areas of assistance and co-ordination between the two

militaries, particularly concerning maritime and, recently, aerial security threats posed by the LTTE. These areas include training of Sri Lankan officers at Indian Defence Universities, which has taken place uninterrupted for decades, and the sharing of intelligence on the LTTE's maritime movements to aid the Sri Lankan Navy in intercepting rogue vessels.

The Indian Navy's intelligence-sharing with the Sri Lankan Navy bolstered the latter's ability to track LTTE supplies and attack its vessels operating around the island. During the final phase of the Sri Lankan war, India helped the Sri Lankan Navy identify suspicious vessels off the coast of Sri Lanka. Thus, in September 2007, the Sri Lankan Navy, possibly acting off information from Indian intelligence, sunk three LTTE supply vessels 600 nautical miles south-east of Sri Lanka.<sup>9</sup> Co-operation between the Indian Coast Guard and Navy and the Sri Lankan Navy involves a frequent exchange of information, expedited by co-ordinating the procedures of operation and ensuring open channels of communication. Every six months the officers of the Indian Coast Guard and Navy meet with their counterparts in the Sri Lankan Navy at the International Boundary Line to discuss logistical issues of co-ordination and communication. Such co-operation reflects India and Sri Lanka's shared strategic interests in maintaining maritime security throughout their bordering waterways and has been expanding since the conflict against LTTE ended. Shortly after the war ended in May 2009, India gave the Sri Lankan Navy a high-tech offshore patrol vessel surveillance ship. The Indian and Sri Lankan navies engaged in joint training exercises in October 2009 and again in April 2010.<sup>10</sup> This post-conflict trend of greater co-operation is likely to continue with more joint exercises meant to develop a collaborative approach to maritime security.

Each year, officers in the Sri Lankan military study at Indian Defence Universities on the invitation of the Indian Government. India's invitation has been extended for decades, and its importance to the quality of the Sri Lankan Armed Forces is duly-noted by Sri Lankan leaders. Such education is a modest way in which India can support its neighbour's military strength without risking domestic and international political repercussions.

Weaponry requests form a large part of Sri Lanka's bid for defence support from India, but India has been reluctant to significantly arm the Sri Lankan military. Under President Mahinda Rajapakse's tenure, the urgency of Sri Lanka's requests fell on unresponsive ears in New Delhi, and India's refusal to arm Sri Lanka's military led critics to accuse India of an inconsistent and uncommitted stand on the LTTE. India placed greater importance on controlling the risk of domestic political repercussions in its Tamil constituency than maintaining a consistent stance on the LTTE. For the six years preceding 2002 India had actually banned transfer of any military supplies to Sri Lanka. From 2002 India's military equipment assistance to the Sri Lankan Armed Forces was limited to 'defensive and non-lethal' equipment, precluding any chance of Indian weaponry contributing to Sri Lankan Tamil casualties in the Sri Lankan Government's military operations. India would not supply offensive or lethal weaponry to Sri Lanka (there was speculation of covert arms transfers) until Sri Lanka conceded basic devolution of powers to the Tamil population.

Even with India's reluctance to supply Sri Lanka with weaponry, in late October 2003 Sri Lankan Prime Minister Ranil Wickremesinghe and Indian Prime Minister A.B. Vajpayee issued a joint statement indicating mutual interest in working towards a Defence Co-operation Agreement (DCA). The DCA sought to formalize existing supply of equipment, troop training, intelligence exchange and joint naval patrolling.<sup>11</sup> After power in both New Delhi and Colombo changed hands, Prime Minister Mahinda Rajapakse's state visit to New Delhi in June 2004 garnered rhetorical support from both sides for expediting the DCA proposed by the previous administrations.<sup>12</sup> Kumaratunga and Indian Prime Minister Manmohan Singh even announced that they agreed to sign not only the DCA, but also a Memorandum of

Understanding on joint rehabilitation of the Palaly Air Force Base. Access to Palaly Air Force Base would offer India greater aerial reach in the Bay of Bengal and Indian Ocean region. However, political hurdles in India's coalition government, most likely on account of opposition from the Tamil Nadu's political parties, have prevented India from signing the DCA with Sri Lanka. Even so, the DCA, presumably still on the table, would only formalize existing defence ties.

## Economic relations

The island of Sri Lanka and the Indian subcontinent engaged in trade dating back to the pre-colonial era. After independence in the late 1940s both countries pursued inward-looking economic development strategies that stifled trade between the two countries despite their close proximity. Sri Lanka opened its economy in 1978—becoming the first South Asian economy to do so—but trade between Sri Lanka and India did not pick-up until India started opening its economy in the 1980s and early 1990s.

After India's 1991 economic reforms, trade between India and Sri Lanka jumped. Two-way trade between 1993 and 1996 doubled. This growth reflected an explosion of Indian exports into the Sri Lankan market, increasing over 500% between 1990 and 1996. In 1995 India eclipsed Japan as the largest source of imports for Sri Lanka. However, Sri Lankan exports to the Indian market grew much less impressively, and this lopsided growth drew criticism that the economic relationship heavily favoured India. This pattern of trade fed the Sri Lankan perception of India as a regional hegemon: the large Indian economy was preying on its smaller and weaker neighbours.

Still, both countries recognized the benefits of free trade with one another. When the SAARC Preferential Trading Arrangement (SAPTA) failed to significantly reduce tariffs after it was launched in 1996, India and Sri Lanka made a bilateral trade agreement. In 1998 India and Sri Lanka signed their bilateral India-Sri Lanka Free Trade Agreement (ISLFTA) with the agreement coming into operation by 2001. The ISLFTA granted duty-free and duty-preference access to goods produced in the two countries and laid out practical steps for a time-bound creation of a free trade area in the near future.

Since the ISLFTA, bilateral trade has markedly increased, accompanied by a surge of Indian investment in Sri Lanka. In 2001 trade doubled. By 2004/05 bilateral trade reached US \$1,690m.; by 2005/06 their trade of \$2,600m. was five times the amount 10 years earlier. By 2007/08 it had reached a peak of \$3,470m., leaving Sri Lanka as India's biggest trade partner in South Asia. Amidst the global recession, figures for 2008/09 showed some reduction, back to \$2,780m., with a further reduction to \$2,580m. in 2009/10. An increase in Indian investment in Sri Lanka reinforced India's commitment to long-term economic engagement on the island. From a meagre \$4m. in the late 1990s, Indian direct investment in Sri Lanka jumped to \$150m. in 2006. By 2005 Indian investment in Sri Lanka accounted for 50% of total Indian investment in South Asian Association for Regional Cooperation (SAARC) countries, making India the fourth highest source of investment in the island, thereby further interweaving the fates of India and Sri Lanka.<sup>13</sup> By 2008 Indian investment increased to \$125.9m., making it the second largest investor in Sri Lanka after Malaysia.<sup>14</sup> The most prominent investments have been in the Lanka Indian Oil Corporation (Lanka IOC), TATAs (Taj Hotels, VSNL, Watawala tea plantations), Apollo Hospitals, LIC, L& T (now Aditya Birla Group), Ambujas, Rediffusion, Ceat, Nicholas Piramal, Jet Airways, Sahara, Indian Airlines and Ashok Leyland. In 2007 some 63% of Indian investment was in the services sector, which contributed to job growth in the struggling Sri Lankan economy.



The ISLFTA was much more than just an economic success. Bilateral economic engagement on the back of the ISLFTA is the hallmark of and impetus for improved Indo-Sri Lankan relations. The benefits of these prospering economic ties extend beyond economic gains to political and strategic relations. The resultant goodwill and increased interaction within the institutional framework and enthusiasm from enhanced economic engagement has helped repair political wounds and advance overall bilateral relations. Most importantly, it helped change the Sri Lankan perception of India as just a regional hegemon.

The trigger for this turn-around was a conscious decision by the Indian policy establishment, outlined in the Gujral Doctrine, to offer its smaller neighbours asymmetrical advantages in trade.<sup>15</sup> This decision foresaw the propitious effects of greater economic engagement in India's strategic relationships with its neighbours. Following the Gujral Doctrine principles, tariff concessions under the ISLFTA signed in 1998, favouring Sri Lanka, significantly reduced the imbalance in Sri Lanka-bound Indian exports to India-bound Sri Lankan exports.

Sri Lankan exports to India boomed under the improved trade arrangements favouring Sri Lankan produced goods. India's 'negative list' (goods not subject to tariff reduction or elimination) included 429 goods compared with Sri Lanka's 1,180, and India had three years to reach zero-tariff level against Sri Lanka's eight. The new arrangements worked to even the trade imbalance. Just two years after the ISLFTA was put into effect, Sri Lankan exports to India increased by 342%. The advantage given to Sri Lanka under the Gujral Doctrine principles had narrowed the trade imbalance to 5:1 by 2002; in 1998 it had stood at 16:1. Since 2003 India has been Sri Lanka's third highest export destination.

In April 2003 the two countries set up a Joint Study Group to enhance the ISLFTA with a Comprehensive Economic Partnership Agreement (CEPA).<sup>16</sup> The much-anticipated CEPA would further remove tariff barriers on trade, create greater market access in the services sector, as well as stimulate greater Indian investment in Sri Lanka through an institutional framework. After more than a dozen rounds of negotiations, CEPA was supposed to be signed by India and Sri Lanka at the SAARC summit in Colombo in August 2008. However, it has been subject to delay, and as of August 2010 had still not been signed even though negotiations seemed to have been pretty well concluded. The India-Sri Lanka Joint Declaration, drawn up in the wake of President Rajapaksa's state visit in June 2010, was rather circumspect on the matter:

Recognizing the considerable benefits from greater economic cooperation between the two countries, the two Leaders noted the progress achieved under the India-Sri Lanka Free Trade Agreement. They agreed that it would be timely to build on this achievement through a more comprehensive framework of economic cooperation, best suited to the two countries. In this context, they directed the concerned officials of the two countries to hold intensive consultations towards developing a framework for sustainable economic partnership between the two countries and addressing outstanding issues.<sup>17</sup>

Sri Lankan business interests concerned with Indian goods overrunning Sri Lankan markets are most likely the cause of the hold-up.

Nevertheless, in the broader view, the growth in trade and investment between India and Sri Lanka marks a shift in India's engagement with Sri Lanka towards the economic realm. Of the three major agreements between India and Sri Lanka, the ISLFTA was the first treaty that was economic in nature.<sup>18</sup> Whereas India's previous Sri Lanka policy focused—and eventually floundered—on controversial political issues, the thrust of the ISLFTA was economic engagement, and its positive spill-over effects in political relations. Since the ISLFTA took effect in

March 2000, expanded economic engagement has become the backbone of the India-Sri Lanka relationship, which has reached new levels of co-operation and trust.

Bolstered economic engagement between India and Sri Lanka, particularly since the ISLFTA came into effect, produced propitious political effects favouring better Indo-Sri Lankan relations. Most importantly, greater equality in terms of benefits from the economic relationship helped overcome Sri Lankan perceptions of subservience to Indian interests. Whereas the attitude toward Indian presence in Sri Lanka turned hostile in the late 1980s, benefits from economic engagement with India have made Sri Lankans, even those among the nationalist ranks, eager for India to play a greater economic role in Sri Lanka. Sri Lankans have been much more receptive to India's economic involvement than they were to its military intervention.

Sri Lankan receptiveness to India's economic involvement opened up an avenue for communication on a broader set of issues. The India-Sri Lanka Joint Commission, reformulated and expanded in 1991 from an earlier joint committee, has institutionalized a framework for economic integration from which the ISLFTA emerged. Formed primarily to address economic issues like trade and investment, the Joint Commission also addresses other areas of co-operation from joint educational and cultural programmes to mutual security concerns like terrorism. Thus, while economic engagement served as the impetus for and continues to drive this institutionalized bilateral framework, the framework also serves as a forum for a wider scope of issues.

India and Sri Lanka are strongly engaging in the strategic energy sector. Indian companies are serving Sri Lanka's energy market and exploring the island's offshore oil resources. Lanka IOC took over a 30% market share in Sri Lanka's retail petrol market in 2005, operating 151 retail outlets on the island. Lanka IOC is building and operating storage facilities at the Trincomalee Tank farm, which, as stated earlier, is of critical importance in the maritime strategic environment. India also has a significant stake in the exploration of oil resources off Sri Lanka's coast. India's Oil and Natural Gas Corporation (ONGC) has been promised one of the five drilling blocks in the Mannar basin.<sup>19</sup> The Mannar basin, thought to contain the equivalent of 1,000m. barrels of oil, has three remaining blocks up for auction; besides the one promised to India, the second of the five has been granted to China.

Most importantly, India is developing port facilities at one of the world's largest deep-water harbours, Trincomalee. Ancient Sri Lankan kings through to the colonial powers used Trincomalee harbour as a naval base and trading port, since it is the only port in Sri Lanka where ships of all sizes can dock in any kind of weather. For India, Trincomalee offers both economic and strategic advantages. The port is an entry and exit point for goods travelling in and out of India, and India is currently refurbishing the infrastructure of an oil tank farm near the harbour that was built by the British in the 1930s. Sri Lanka has a naval base at Trincomalee, and it is likely that if Indian and Sri Lankan naval co-operation continues, the Indian Navy will have some amount of access to the harbour.

## China and Sri Lanka

India has perceived Chinese economic interaction with Sri Lanka as encroachment into its strategic territory; they are both there in what Harsh Pant sees as a 'great game' in the Indian Ocean.<sup>20</sup> The supply of defence equipment to a Sri Lankan military at war provided one of the major in-roads for China (and Pakistan) to gain strategic influence within Sri Lanka.<sup>21</sup> China was willing to provide Sri Lanka with the defence support it needed to pursue a military solution against the LTTE. India was aware of the nature and development of these relationships, though it had no power to stop China from meeting Sri Lanka's defence needs. India's domestic

political compulsions prevented it from challenging the roles played by China and Pakistan—the restraints of coalition politics allowed for lesser defence ‘carrots’ than Sri Lanka needed, and the bitter memory of the failed IPKF experience lingered. India’s political compulsions worked against its strategic imperative to keep major powers from gaining inroads into Sri Lanka.

During the war, Sri Lanka and China made multiple defence deals centred on arms transfers. These deals included a \$37.6m. contract between Sri Lanka and China’s Poly Technologies, signed in April 2007. Sri Lanka’s debt to Norinco, another defence supplier, was reportedly \$200m. Sri Lanka gained large amounts of mortar shells, artillery shells, mortar bombs, JY 11 3D radars, anti-aircraft guns and Jian-17 fighter jets. China also helped fulfil the Sri Lankan Navy’s ‘shopping list’ of weaponry and munitions needs. Such military help was seen by many as having been crucial in enabling the Sri Lankan Government to achieve military victory and crush the Tamil Tigers in 2009: ‘an unfettered China is supporting Colombo and, in the process, authenticating India’s fears about Beijing extending its influence in the Indian Ocean’.<sup>22</sup>

Indian concern has focused around the Chinese developing the Hambantota port on the southern tip of Sri Lanka. Chinese contractors are currently working to finish Phase One of the project by the end of 2010, at a cost of \$76.5m. The work includes building a 1.3-km jetty to shelter the harbour, and an oil refinery. At the end of the initial phase, the facility will be a bunker terminal (bunker fuels are used to power ships) with a capacity of 500,000 metric tons. The Sri Lanka Ports Authority indicated that it would rent out storage space to private domestic and foreign firms, and presumably this will include Chinese firms. The entire project has four phases, with the contract for Phase Two signed in June 2010 with the China Harbour Engineering Company Ltd. It is all expected to be completed by 2022, some 15 years after it was started, though the economic success or failure of the first stages will determine if the entire plan is carried out.

China’s interest in the Hambantota port is consistent with its desire to supply ample refuelling terminals along Indian Ocean shipping lanes to support an increasing amount of sea-based trade. It has also partnered with other neighbouring states to develop port facilities in Gwadar (Pakistan), Chittagong (Bangladesh) and Sitwe (Myanmar).<sup>23</sup> For China, this is a strategic imperative rather than just a foreign investment to bolster its growing economy. The majority of China’s oil travels this Sea Line of Communication, in which any increasing maritime security concerns off the coast of Somalia and in the Malacca Straits threaten China’s energy security.

Though China’s ‘blue water’ Navy is below the US Navy, and (in some areas) the Indian Navy, it is placing a lot of resources into developing greater capabilities so that it can eventually exert greater control over its maritime trade routes. India worries that a Chinese presence in Hambantota will one day include the Chinese Navy. Both China and Sri Lanka deny any plans for a Chinese naval base in Sri Lanka, but India continues to worry about the possibility. India’s fear is that if Sri Lanka were to grant naval access on the island to China, Chinese encirclement of India with a ‘string of pearls’ (ports) in the Indian Ocean region would become a reality.<sup>24</sup>

## Conclusions

The end of the Sri Lankan conflict in May 2009 provides an opening for closer Indo-Sri Lankan relations. Will there be a large jump in bilateral co-operation between 2010 and 2015 and beyond? The answer likely depends most on whether the Sri Lankan majority Sinhalese and minority Tamils achieve political reconciliation. The Government of Sri Lanka militarily defeated the LTTE, so the conflict ended without political reconciliation. The grievances of the Tamil minority that originally inspired popular support for the insurgency have for the most part not been addressed. Until the Government of Sri Lanka addresses Tamil demands for

minority rights and equal educational and economic opportunities, the underlying ethnic tension of the conflict will remain. For India, this means that its policy dilemma discussed above will continue to constrain its relationship with Sri Lanka.

## Notes

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