

# ISAS Insights

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## **Sri Lanka's Role in the Indian Ocean and the Changing Global Dynamic<sup>1</sup>**

*In light of the regional and global developments, the government of Sri Lanka has embarked on a mission to leverage Sri Lanka's location in the nautical corridor between the east and west, and make it a hub of the Indian Ocean, as well as a key transshipment port for the Bay of Bengal trade. It aims to maximise relations with regional players such as China, Japan and India to encourage trade and foreign investments in Sri Lanka.*

Harsha de Silva<sup>2</sup>

The 9<sup>th</sup> of January 2017 marked the second anniversary of an important turning point in Sri Lanka's recent history. It is the beginning of the third year of the five-year term of President Maithripala Sirisena. On 8 January 2015, the people of Sri Lanka took part in polls and, on 9 January 2015, switched from a government that had embarked on an authoritarian and divisive trajectory to one of convergence and national unity. For the first time since independence, traditional rivals in Sri Lankan politics eschewed adversarial politics to undertake pressing

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<sup>1</sup> This is a transcript of Dr Harsha de Silva's presentation at the Public Forum on 'The Indian Ocean', organised by the Institute of South Asian Studies (ISAS), an autonomous research institute at the National University of Singapore, in Singapore on 9 January 2017. The Public Forum is the inaugural session of the ISAS Distinguished Visitors Programme.

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political and economic reforms in the long-term interest of the people. Sri Lankans demonstrated to the world that they could change a well-entrenched government, long considered to be undefeatable by using the ballot. It was an unexpected outcome to many within and outside Sri Lanka and demonstrated the importance of democracy.

## **Optimism in the Changing Global Dynamic**

In the last two years, Sri Lanka has achieved some notable successes as well as faced some complex challenges that have slowed its progress. It is a trajectory that is inevitable in a democracy. Sri Lankans are a resilient people who sustain a sense of optimism about the potential of their country even in the darkest moments of our history. Now perhaps for the first time in Sri Lanka's contemporary history, the future holds more promise than doubt. The people believe that they are at a stage of economic growth and political maturity which, combined with opportunities presented by global and regional developments, will propel them to the next stage of development if they play their cards right. Therefore, it is with a sense of optimism that I approach this topic on Sri Lanka's role in the Indian Ocean and the changing global dynamic.

The moment one hears the two words, Sri Lanka, his or her mind travels to South Asia. However, for centuries, Taprobane, Ceylon, Sri Lanka or whatever the island was referred to, was the heart of the Indian Ocean. Therefore, the people would like to position Sri Lanka as the centre of the Indian Ocean, rather than just a South Asian nation. The future prosperity of the nation relies on how well it leverages its location in the Indian Ocean. In order to accomplish its goals, it must be vigilant to regional and global developments that will aid or hinder its path.

Last year was a tumultuous year in politics and economics. Sri Lanka is witnessing momentous changes in the structure of the global economy brought about by the relentless influence of globalisation. It is reasonable to be concerned with the rapid pace of change and what it means for our economies. The effect of Brexit and other possible exits from the European Union and trade policies of United States (US) President-elect Donald Trump will take some months, even years to manifest and everyone will be observing with interest the interactions between China and the incoming administration in the US. It is in this context that one says that uncertainty is the 'new normal' in business life. Those organisations and countries that thrive in an era of

uncertainty will be those who seize the opportunities presented by these uncertainties and take actions that can avert disasters and promote confidence and recovery. The emerging uncertain global dynamic will present both challenges and opportunities for those in the Indian Ocean.

## **Sri Lanka's Historical Role in the Indian Ocean**

Sri Lanka's location has shaped its history intrinsically for millennia and will continue to be so in the future. In ancient times, Sri Lanka was important as the half way point between the two great empires of Rome and China and near the equator where our navigational winds and monsoon effects changed directions. Therefore, it has strategic geographical advantages where global and navigational contexts were concerned. It featured prominently in the spice routes which were also called maritime silk roads. In fact, it is said that cinnamon from Sri Lanka and cassia from China found their way along the Spice Routes to the Middle East as far back as 2000 BC. Foreign merchants were attracted to ancient Taprobane because of its importance as a centre of international trade and some of them even settled in the islands, particularly Moors, descendants of Arab traders. They were a dominant influence on the islands' international trade in the Polonnaruwa period, between the 11<sup>th</sup> to 13<sup>th</sup> century periods. The Moors maintained this dominance until the early decades of the 16<sup>th</sup> century.

An examination of the foreign relations of the island under the Polonnaruwa Kings reveals political linkages with Southeast Asia, in particular Myanmar and Cambodia. Peace and prosperity along the Maritime Silk Road helped increase the volume of international trade via the Indian Ocean from which Sri Lanka naturally profited. Much of the trade was in luxury goods, and in that respect Sri Lanka was the transit point as well as a terminal point. The latter was due to Sri Lanka's own considerable luxury products such as gems and pearls. However, ancient Sri Lanka was a largely self-sufficient agrarian economy, where the role of trade was a generally peripheral activity. It was only after the collapse of the ancient Hydraulic civilization in the Polonnaruwa period that the country's rulers began to give greater attention to the economic possibilities of trade. Exports of spices, particularly cinnamon, became a particularly lucrative activity.

During the 13<sup>th</sup> and 15<sup>th</sup> centuries, Sri Lanka's position as a trade hub on the East-West maritime route had been established, as had its position as a gateway to India. Sri Lanka had direct commercial links with Malacca and with regions in India such as Gujarat and Bengal.

During the colonial rule by the Portuguese, Dutch and lastly the English, the volume of trade expanded. The tea trade, which was started by the British, still plays a significant role in the Sri Lankan economy. However, in the last 500 years, the Indian Ocean region lost its geopolitical and geo-economic relevance first to colonial dictates and, thereafter, post-colonial cold war concerns.

## **Sri Lanka's Strategic Role in the Indian Ocean**

Now for the first time in five centuries, global economic balance of power is once again shifting towards Asia. It is estimated that, by 2030, Asia will surpass North America and Europe combined in global power based on gross domestic product (GDP), population size, military spending and technological investments. The global financial system is also moving away, albeit slowly, from the dollar dominated international system to a more multi-currency system. The new consumer markets are emerging all across Asia, and the Asian middle class is expanding rapidly. Of the four largest economies of the world – US, China, Japan and India – three are located in Asia. The busy East-West shipping route passes just six to ten nautical miles south of the island with more than 60,000 ships plying this route annually carrying two-thirds of global petroleum, half the supply of container cargo and more. Thus, Sri Lanka's situation in the nautical corridor between the East and West is not only of importance from a geostrategic perspective but also from a maritime, economics and security perspective.

Sri Lanka is a small country –it can't change the geopolitical realities of the region surrounding us. Hence, a wise foreign policy is essential not only for the present but to ensure prosperity and safety of future generations.

Along with many opportunities, the renewed interest in Asia will also bring vulnerability to emerging competition among major naval powers. The blue water naval capabilities of key Asian states have ushered a new strategic environment and the Indian Ocean has become an important geo-strategic space. While the maritime space of Asia is strongly connected to the Indian and Pacific Oceans through trade and commerce routes, there is a difference in the power dynamics of the Pacific and Indian Oceans. The power play in the Pacific is dominated by its proximity to the US, centrality to the US security policies and now the rise of the Chinese naval power. In contrast, the Indian Ocean region has a multipolar characteristic.

This transition in global power to Asia started with the economic awakening of East Asia, driven by the growth of China and the complementary growth of the Association of Southeast Asian Nations (ASEAN) countries, particularly Indonesia and Vietnam. While the South Asian region has not matched the same level of development, the region is acquiring an intrinsic significance of its own, underpinned by the growth of India. Currently India is the fastest growing large economy in the world. In the future, the power transition in the Indian Ocean will be heavily influenced by South Asian developments.

The Indian Ocean plays a crucial role in the future of both China and India. The sea routes through the Indian Ocean are very important to China's maritime trade and energy supply. Therefore, both countries will have to respect each other's legitimate interest in ensuring that their future prospects are not affected in the long term.

Unlike the Asia Pacific, the Indian Ocean region is not economically integrated. No single power or coalition will be able to maintain peace and stability on their own in the Indian Ocean. In capacity terms also, no country is capable of handling the maritime security threats and challenges in isolation, no matter how advanced or developed it might be. In addition, it is preferable that the region continues its historic and multi polar characteristics to prevent a spill-over of tensions from other regions. In such a background, all maritime nations have a role to play in ensuring the overall balance of strategic weight. Smaller nations such as Sri Lanka, even with comparatively limited maritime resources, can become an integral element of security in the region.

The Indian Ocean is in need of a mutually benefiting security architecture established on a multilateral basis. There is also space for an effective multilateral governing structure. In this regard, the Prime Minister of Sri Lanka has expressed an interest in crafting an Indian Ocean Order with accepted rules and agreements that would guide interactions between states. Speaking in Singapore in 2016 at the inauguration of the Indian Ocean Conference, Mr Ranil Wickremesinghe called for this Order to be built on consensual agreement in which no state is allowed to dominate the system.

The Indian Ocean Order would have the primary responsibility of upholding the freedom of navigation in the Indian Ocean ensuring that shipping and air routes to East Asia and beyond are kept open. This will help build closer economic cooperation amongst countries in the region. In this regard, the Prime Minister has called for a dialogue between South Asian Association for Regional Cooperation (SAARC) and ASEAN leaders. Perhaps that can happen

sooner than later, and Sri Lanka would be delighted to play a role. Be that as it may, Sri Lanka remains committed to preventing international terrorism, transnational crimes and people smuggling in the seas around our country. Supplementing the blue water capability of the Sri Lanka navy and the consolidation of the coast guards are areas of concern for our government. It is also reviewing possibilities of integrating the capabilities of our navy and air force.

## **Repositioning of Sri Lanka**

The government of Sri Lanka has a clear vision of what it wants to be in the world today. It is repositioning itself to maximise its relationship with both historic and new trading partners, to leverage our geostrategic position and make it a hub of the India Ocean as well as a transshipment port for the Bay of Bengal trade. To fully realize this potential, Sri Lanka is engaging in initiatives with regional players who have major economic stakes in the Indian Ocean. It is also pushing to further integrate with the world by undertaking reforms to facilitate trade and encourage productive foreign investments. It has set a target of boosting exports to US\$20 billion in 2020 and increasing exports by nearly 80 per cent between 2016 and 2020. It is unfortunate that in the last decade also of the previous government, Sri Lanka lost its focus, with exports to GDP falling from 34 per cent to less than 14 per cent. So it is critical that Sri Lanka implements its plans to leverage its competitive advantages as planned. Unlike ASEAN, which provided its members with a stable and peaceful environment to focus on economic development in formative stages of their countries development, SAARC has not been able to achieve the same level of regional integration. These geopolitical realities require that Sri Lanka build strong bilateral relations with the Bay of Bengal members of ASEAN, in addition to its fellow South Asian members. In sum, Sri Lanka cannot be content with its traditional markets and its must thus look beyond for new opportunities.

India and Sri Lanka hope to finalise an economic and technical cooperation or Indo-Sri Lanka Economic and Technology Cooperative Agreement (ETCA) by 2017. The ETCA will enhance the scope of India and Sri Lanka's Free Trade Agreement (FTA) to extend freer movement of goods and services, with the added emphasis of cooperation on development of technology and investment. The ETCA will provide an impetus to existing synergies and has the potential to

promote rapid growth in the sub-regional economy between Sri Lanka and the five South Indian States.<sup>3</sup>

Sri Lanka is also negotiating an FTA with Singapore. Singapore already has a Comprehensive Economic Cooperation Agreement (CECA) with India.<sup>4</sup> Therefore, Sri Lanka believes that, by next year, the Singapore-India CECA, the India-Sri Lanka ECTA and the Sri Lanka-Singapore FTA will enable another southern sub-region of South Asia and Singapore to establish a tri-partite arrangement for trade and investment.

Sri Lanka supports the One Belt, One Road Initiative, in line with the major historical role we played in the Maritime Silk Route. This will consolidate its position as a hub of the Indian Ocean while further integrating us with the Asian markets. Chinese investments will be primarily directed towards industrialisation and further development of the Hambantota Hub in southern Sri Lanka. In addition, a US\$1.4 billion reclamation is now underway, adjacent to the city of Colombo, for the creation of a 560-acre financial city under English law, to fill a vacuum for offshore financial services between Singapore and Dubai. Chinese investors have made significant commitments to invest equity in the China-debt strapped Hambantota port and the Mattala international airport the previous government built; now as public-private partnership ventures.

The Sri Lanka government is currently negotiating a US\$1.3 billion lease agreement with China Merchants Port to lease the currently empty deep sea port, in order to integrate it with the proposed industrial zones. In addition, we inaugurated the 15,000-acre Sri Lanka-China logistics and industrial zone to become a serious player in the global production network. It was revealed at the inauguration that Chinese investors were ready to bring in US\$5 billion in investments in the zone over the next three years.

Economic cooperation with Japan is as important to Sri Lanka. It is grateful for four decades of Japanese donor assistance that have made significant impact on its social and economic development. The Japanese Prime Minister, Mr Shinzō Abe, has also appointed a senior official to coordinate the Japan-Sri Lanka Joint Comprehensive Partnership Program that was initiated

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<sup>3</sup> South India consists of the five southern Indian states of Andhra Pradesh, Telangana, Karnataka, Kerala and Tamil Nadu.

<sup>4</sup> "India – Singapore Comprehensive Economic Cooperation Agreement (CECA)." India – Singapore Comprehensive Economic Cooperation Agreement (CECA). N.p., n.d. Web. 13 January 2017. <<https://www.iesingapore.gov.sg/Trade-From-Singapore/International-Agreements/free-trade-agreements/CECA>>.

last year.<sup>5</sup> After a lull, Japan is once again getting involved in major infrastructure projects in Sri Lanka including light rail and expressways.

Many may not be aware that Sri Lanka is home to the second largest natural harbour in the world in Trincomalee – it is said to be one of the finest deep sea harbours in the world. Sri Lanka has now initiated action to develop this port centered on the large Trinco development zone. The government is working with India and Japan, with Surbana Jurong of Singapore being contracted to draw up a city master plan. The proposed container terminal in Trincomalee Port will serve trade in India's east coast as well as Bangladesh and Myanmar.

With the strong interest in utilising the zones along the south west corridor centered around Colombo port and western megapolis, logistics and industrial zones located near the Hambantota and the north-east corridor centered around the Trincomalee port developed by investors from China, Korea, Japan and also likely from India, Sri Lanka plans to create an export market focused on Europe, China, Japan, US and the crescent of markets around the Indian Ocean. In the Middle East, Iran, Afghanistan, Pakistan, India, Bangladesh, Myanmar, Thailand, Malaysia, Singapore and Indonesia, there exists a fast-growing population of over two billion people. This combined market has the potential of three billion consumers by 2050.

Going forward, Sri Lanka's development strategy will be aimed at capturing trade opportunities within this identified Indian Ocean market by pursuing trade liberalisation agreements with their governments. It has already made the application with the European Union to regain the Generalized System of Preferences Plus facility for preferential access to the single market, and are hopeful of an agreement by next year. A concerted effort is also underway to improve the business climate, domestic reforms that are rule-based and make business and investment more secure. Sri Lanka is taking measures to increase the ease of doing business more directly, for example, it is bringing a number of different agencies together to create a one-stop investment and trade facilitation shop.

Sri Lanka is reviewing its laws and regulations to create a simple rules-based business environment, including those related to land ownership, as well as tariffs and para-tariffs. It has adopted policies that enable private enterprise to thrive, for example, Sri Lanka has a simple three-tier tax rate with the lowest at 14 per cent. Together, these reforms – alongside our

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<sup>5</sup> “Joint Declaration on Comprehensive Partnership between Japan and Sri Lanka.” (n.d.): n. pag. [Http://www.mofa.go.jp](http://www.mofa.go.jp). Ministry of Foreign Affairs Japan. Web.



educated workforce and solid infrastructure – are making Sri Lanka the most attractive, secure and competitive investment destination in the region.

## **Conclusion**

In conclusion, the security of the Indian Ocean is of primary interest to those located in the Indian Ocean region, since it is directly linked to their economies. Therefore, managing competition and strengthening cooperation would be essential, given that both these economic and strategic security factors will have a direct impact on the future of this region. There will always be tension between large countries and their smaller neighbours. However, the countries in the Indian Ocean region have more in common in terms of history, culture and religion than what sets them apart. Sri Lanka believes the Indian Ocean region now has an extraordinary opportunity to create something new and uniquely beneficial to its own people.

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