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## **THE BATTLE FOR INFLUENCE IN SRI LANKA: THE CASE OF HAMBANTOTA**

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## **The battle for influence in Sri Lanka: the case of Hambantota**

Recently, Sri Lanka, an island country in the Indian Ocean with a population of just over 22 million, has been atypically present in news headlines worldwide. Economic troubles have been plaguing the debt-ridden island nation since 2019, evolving into a political crisis that climaxed in July 2022, when anti-government protestors stormed the residence of the president. The storming followed years of crisis, during which the government declared the nation's economy had collapsed. The economic disaster that has been described as the worst crisis in the country's history resulted in high inflation, severe fuel and power shortages, as well as a food emergency.

There is a general agreement that the collapse was caused by government mismanagement. Excessive borrowing following a significant hit to Sri Lanka's tourism industry in light of the Covid-19 pandemic and deadly terrorist attacks combined with imprudent tax reforms caused the already unbalanced accounts of the state to turn worse (BORGAN, 2022). With the public debt rising and foreign reserves shrinking, the nation was bound to face economic difficulties. Nevertheless, as China is taking an increasingly prominent role in Sri Lanka's affairs, there is a tendency to portray Beijing as the ultimate culprit behind Sri Lanka's economic turmoil (Kairo, 2022). Even though China had never held a large sum of Sri Lanka's foreign debt, given the tense atmosphere of international affairs with China and the United States vowing for influence in economically under-developed countries, some commentators have been eager to point the finger firmly at Beijing, accusing the rising superpower of predatory lending and debt trap diplomacy.

Historically, Sri Lanka was always close to the West. After being colonized by the Portuguese, Dutch, and British, Sri Lanka gained independence in 1948 and aligned itself with the West. Following disputes with Washington over trading with China, a case of "Sino-Lankan cooperation in the face of international condemnation" that would repeat itself six decades later in the Hambantota deal port, Sri Lanka soon found itself balancing the influence of several big powers and joining the Non-Aligned Movement (Freyman, 2021, p. 102). Concerned with potential communist influence in Sri Lanka, the West set out to loan Colombo large development loans. Yet, China continued to be an important partner to the island nation. Sri

Lanka aimed to balance Indian hold of the island, even going as far as to help Pakistan during the Indo-Pakistani War (ibid).

In the coming years, both Beijing and New Delhi competed for influence in the state, signing military agreements and offering aid. India and the US remained worried about the close relations between Sri Lanka and China even after the Cold War ended. Called an “aircraft carrier parked fourteen miles off the Indian coast” by an Indian National Security Advisor (Freymann, 2021, p. 105), the island was always an important part of India’s foreign policy. New Delhi played a prominent part in the Sri Lankan Civil War, deploying a Peace Keeping Force in 1987 and engaging in rehabilitation programs after the war ended. Recently trade between countries has been increasingly combined with high-level exchanges of visits at regular intervals. India is Sri Lanka's largest trading partner and one of the largest contributors to Foreign Direct Investment. Nonetheless, China has remained a point of conflict for the neighboring states, with both Beijing and New Delhi recognizing Sri Lanka as a critical player in the geo-strategic game for dominance in South Asia.

As mentioned, throughout history, Colombo and Beijing have managed to form close ties. Plentiful choices of foreign financing gave Sri Lanka a great deal of leverage. Instead of following orders from the West, Colombo would turn to China, causing headaches to both Indian and American officials (Freymann, 2021, p. 106). Recently, Sri Lanka has supported China at the international level on several occasions, including regarding the treatment of the Uyghur minority (Tamil Guardian, 2022), the South China Sea dispute (CCTV, 2016), and the Hong Kong national security law (Lawler, 2022). In addition, the states have formed substantial defense ties (Roy-Chaudhury, 2019). Sri Lanka is also a part of the notorious Belt and Road Initiative (BRI) initiative. Thus, Colombo “has consistently been willing to strike deals with China, provided that the price is right” (Freymann, 2021, p. 107).

However, the relationship is not without contradictions, as the case of Hambantota port shows well. The issue has been the topic of several news articles, with some arguing that it sets a clear precedent on why countries should not seek closer ties with Beijing. In 2018 the Chinese government agreed to pay \$1.2 billion to Sri Lanka in order to cancel the debt that Sri Lanka had taken out to finance the Hambantota port. In return, Sri Lanka agreed to hand over the port and the surrounding infrastructure on a 99-year concession to a Chinese-controlled joint-venture. The United States predictably responded with alarm. Mike Pence, then US Vice President, accused China of practicing debt diplomacy to expand its political and military

influence, with Hambantota being the prime example: "Just ask Sri Lanka, which took on massive debt to let Chinese state companies build a port with questionable commercial value. Two years ago, that country could no longer afford its payments – so Beijing pressured Sri Lanka to deliver the new port directly into Chinese hands. It may soon become a forward military base for China's growing blue-water navy" (Pence, 2018).

A closer look at the development surrounding the Hambantota port paints a significantly different picture. China did not pressure, let alone deceive, to seek funding for the port or pressure Sri Lanka to join the BRI. Sri Lanka has tried to maximize its autonomy and security between big powers and resisted relying too heavily on one country, particularly India. Furthermore, from the start, Sri Lanka knew that the Hambantota project would not be viable without outside funding.

Hambantota port was Sri Lanka's idea. The idea has been reportedly discussed since the British left Sri Lanka. Moreover, in 2002, the Sri Lankan government already negotiated a \$400 million deal for the port with two Canadian companies, but nothing came of that deal. In 2002 Canadian firm SNC Lavalin was hired to conduct a feasibility study. Brautigam and Rithmire (2021) obtained more than 1000 pages of documents, showing that the study concluded the possible feasibility of the project. Cooperation with the Canadians did not materialize, but the project gained traction under Rajapaksa, elected president in 2005, and a new feasibility study produced by the Danish company followed in 2006. It made a similar conclusion as the Canadian report. In 2006 searching for funding for the construction of Phase I, Sri Lanka approached the US, India, Japan, the IMF, World Bank, and the Asian Development Bank, but they all declined. Sri Lanka turned to China as a lender of last resort. A \$307 million 15-year commercial loan with a four-year grace period was offered to Sri Lanka with a 6.3 percent fixed interest rate, a lower rate than the one Colombo would get on the capital markets (ibid.).

In 2009 the Sri Lankan civil war ended. Subsequently, Sri Lanka took out several loans to finance reconstruction, with projects such as the 35,000-seat cricket stadium. Instead of waiting for revenue from Phase I at Hambantota port (as the feasibility studies instructed), Mahinda Rajapaksa pushed forward to Phase II of the project. Sri Lanka borrowed \$757 million from China Eximbank on a concessional term – a highly favorable 2 percent interest rate (Freyman, 2021, p. 113). By 2014, however, Hambantota was losing large sums of money.

The agreement was in doubt after Rajapaksa lost his reelection to Sirisena, who ran on an anti-China campaign and immediately froze different BRI projects in Sri Lanka. The new

government plan was to hope that India and the West would come and salvage the nation, but that did not happen (Foizee, 2020). Importantly, when both the US and India refused to engage, Sri Lanka had to return to the negotiation table with China in a weaker position (Freyman, 2021, p. 121). The commander of the Sri Lankan navy concluded that: "India has strategic objectives, but not strategic patience or strategic capability" while "China has all three" (ibid.). Sirisena's government was already in a difficult situation, with steep payments on international sovereign bonds that represented 40 percent of Sri Lanka's external debt (Brautigam and Rithmire, 2021). Sri Lanka owed far more to the Asian Development Bank, World Bank, and Japan than China. Crucially, only 5 percent of the \$4.5 billion in debt service Sri Lanka would pay in 2017 was because of the Hambantota project. Subsequently, two Governors of the Central Bank of Sri Lanka argued that "Hambantota, and Chinese finance in general, was not the source of the country's financial distress" (ibid.).

Sri Lankan government saved itself from default by negotiating a bailout from the International Monetary Fund. Part of raising funds was to leave out the underperforming Hambantota Port to an experienced company, which is exactly what the Canadian feasibility study recommended in 2003 (ibid.). Only two bids came for the Hambantota project, from the China Harbour and China Merchant. The latter was subsequently chosen and became a majority shareholder with a 99-year lease (Freyman, 2021, p. 122). A \$1.2 billion infusion from China was used to increase Sri Lanka's foreign reserves and not to pay off China Eximbank (Brautigam and Rithmire, 2021).

With the announcement of the Chinese acquisition of the swap, fears were aroused in US and India about China using the port as a military base in the future. But this was again an overreaction as Sri Lanka claimed they achieved strong prohibitions of preventing usage of Hambantota port for military-related activities (Aneez and Sirilal, 2018). Furthermore, the port is far from suitable for military purposes. After the Port handover, Sri Lanka embraced BRI even further, signing two BRI memoranda of understanding and committed to partnering with Beijing to implement a long-term development plan. China is trying to make Hambantota a commercial success with new investments announced by a Chinese oil company. They also doubled the number of ships calling at the port in 2018 (Freyman, 2021, p. 126). Furthermore, Chinese investment attracted investments from other countries, with Omani and, importantly, Indian governments winning approval to build a \$3.8 billion oil refinery in the Hambantota area.

So, while it is easy to point the finger at China, things are far more complicated than they may seem at the first glance. Importantly, no other country was as worried about Hambantota as India (Brautigam and Rithmire, 2021). Yet, New Delhi spurned Colombo's requests for investment at the time. During the ongoing crisis, however, India has been far more active in providing credit and emergency aid. On the other hand, protesters have been regularly chanting anti-Indian slogans. According to the BBC, chants like “do not sell the country to India and the US”, “India: Sri Lanka is not another state”, and “India do not exploit Sri Lanka's situation”, could be widely heard during the protest with some experts warning India has been using the crisis to regain influence on the island (Ethirajan, 2022). Furthermore, in contrast to the Hambantota case, an unofficial exchange of Indian emergency credit for an agreement to jointly operate 61 oil tanks and a majority stake in a contract to build a new port facility at the important Trincomalee harbor by an Indian company went by largely unnoticed (ibid).

As Sri Lanka holds an important strategic location, geopolitical rivalries are practically unavoidable. With China presented as a culprit for the current economic issues combined with the relative reluctance to write off Sri Lanka's debt, India has been regaining ground on the island. Next to the already mentioned strategic oil terminal, India successfully signed a deal to work on hybrid power plants with a private contractor taking over the plan to build a wind farm in Colombo; both projects were wrestled away from the Chinese. On the other side, China has stated clearly that it does not compete with India but only aims to achieve economic progress (Ethirajan, 2022). Notably, it was also an Indian-led business that engineered the long-term plan for the Hambantota Port (Brautigam and Rithmire, 2021).

Globally, it is crucial to note that throughout its recent history, Sri Lanka has been heavily borrowing from the West. Only 10 percent of Sri Lanka's foreign debt is owned by China, with the majority belonging to Western financial institutions. Sri Lanka has borrowed a great deal from the International Monetary Fund, always with stringent conditions (Samarajiva, 2022). Sri Lanka's situation is not an unknown precedent. Small states around the globe have been left with no choice but to accept predatory loans to improve their undeveloped economies. Sixty percent of low-income countries are in or are in great danger of being in debt trouble. The list of countries at risk is expanding quickly and includes Pakistan, Bangladesh, Tunisia, Ghana, and Sudan (ibid). With Colombo's economy still largely dependent on the export of cheap labor and resources, combined with a neoliberal economy that seems evermore unprepared to solve future crises, Sri Lanka is unlikely to come out as a winner, no matter from where the dollars pour in.

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