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Sri Lanka Suffers from China's Indian Ocean Strategy

BY SHIYANA GUNASEKARA

Shiyana Gunasekara, former Fulbright Scholar in Sri Lanka, explains that “This should be of particular concern to India, since China has used the Colombo South Container Terminal to dock submarines, as opposed to the Sri Lanka Port Authority’s mooring designated for military vessels.”

Amidst local protests against the Chinese presence in the southern Sri Lankan town of Hambantota, Beijing insists that the town’s port project has been discussed in the “spirit of equality and mutual benefit, and follows market rules.” China’s activity in the Indian Ocean — particularly in Sri Lanka, which is a focal point in China’s One Belt One Road (OBOR) plan — appears to be predatory lending under the guise of economic development. India needs to recalibrate its strategy towards the other South Asian countries for its own security, if not regional stability; however, Delhi has yet to offer a comparable alternative to doing business with China. Instead, India has taken its asymmetric power in the region and the de facto allegiances of its much smaller neighbors for granted. With China’s recent track record of placing military vessels in traditionally commercial docks, India must take its role as the South Asian hegemon seriously.

In October 2016, Sri Lanka’s Prime Minister Ranil Wickremesinghe announced that the China Merchants Holdings (International) Company Ltd. would hold an 80% share of the Hambantota Port in exchange for over USD \$1 billion in the country’s debt. This should be of particular concern to India, since China has used the Colombo South Container Terminal, owned by the same Chinese firm, to dock submarines, as opposed to the Sri Lanka Port Authority’s mooring designated for military vessels. Previously, Colombo intended to hide visits of two other Chinese naval vessels from the media. With the majority of the Hambantota Port sold to China’s semi-private sector, India should be prepared for another visit by the People’s Liberation Army (PLA) Navy — perhaps for a much longer period of time.

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The complete details of Chinese loans and other financial assistance have not been disclosed to the public, notably including details of the loan interest rates. China leads the country’s foreign inflows, with 98% of Chinese assistance to Sri Lanka being loans and only two percent as grants. China’s Export-Import Bank accounts for 77% of these loans, with 14% coming from the China Development Bank, and five percent from interest-free loans. China’s Export-Import Bank has notoriously given loans to countries on its OBOR initiative with strict self-serving procurement and contracting regulations: Chinese companies must be awarded the contract, both for the

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project itself and for procurement, and at least 50% of project procurement must be services, equipment, technology and materials from China.

Foreign direct investment and other forms of financial engagement from a G2 country to an emerging economy should be focused on market-friendly approaches to supporting economic development in the latter. Chinese investment in Sri Lanka, and other countries along China’s visionary trail would be a true boost to the local economy if the loan money were staying in the country through greater local employment and project procurement. Instead, Sri Lanka borrows money from China, which China requires to be used to contract largely state-owned Chinese companies. These companies provide salaries to Chinese employees who come to Sri Lanka to build infrastructure projects using mostly Chinese materials and technology.

The Mattala Airport and the Hambantota Port are prime examples of large-scale infrastructure projects financed by China that did not promote local economic development. These projects were purely gambles by the former Sri Lankan government, for which there was no guaranteed return on investment — a risky move for an economy coming out of an expensive three-decade war.

Sri Lanka, undergoing vast economic reforms outlined by the International Monetary Fund (IMF), might not be the only South Asian state that will have to be bailed out due to crushing Chinese-owned debt. An IMF report on the Chinese-Pakistan Economic Corridor (CPEC), noted that import requirements of the project “will likely offset a significant share of inflows, such that the current account deficit would widen.” While the IMF acknowledges that the long run benefits may help mitigate said costs, such success is not guaranteed, as seen in Sri Lanka. Hence Pakistan too should take into serious consideration the equity-for-debt swap that Sri Lanka was forced into due to the island nation’s ill-advised decisions and China’s over-eagerness to offer self-serving loans.

India is the largest power in South Asia in essentially every measure, and should continue to initiate deeper maritime collaborations with its neighbors for its own interests as well as for the benefit of the region. India can accomplish this goal by providing fiscal alternatives for its smaller neighbors to develop their infrastructures and human capital that are more favorable than Chinese-financed loans with unclear intentions.

China is a pragmatic power, and most likely foresaw Sri Lanka’s economic decline that resulted in Chinese ownership of the Hambantota port. China’s actions of fostering questionable loan conditions and blurring the line between commercial and military objectives do not correspond to its purported aim of establishing a positive public image. Ultimately, if China commits to increased transparency, its ambition to become a re-emerging global power will be better received.

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