

## **China's debt-trap diplomacy and geopolitical impacts on Sri Lanka**

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### **Introduction**

During the last decade, the external debt servicing payments of Sri Lanka surged posing an imminent threat to the external sector of the economy. This vulnerability, resulted in largely due to the transformation of external debt dynamics in Sri Lanka during the last decade as a result of raising funds through sovereign bonds at commercial interest rates and borrowings through export credit at higher interest rates, led to economic as well as geopolitical concerns.

Data reveals that in 2006, Sri Lanka's external debt stock was only \$10.6 billion and it has increased to \$ 25.3 Billion by 2016. It was observed that significant portion of external debt is owed to China. This is identified as a part of a global scenario observed by Murphy who argued that there is significant overseas lending, primarily through the Export-Import Bank of China (China EXIM Bank) and the China Development Bank (CDB) and the amount of lending exceeds \$ 100 billion establishing Chinese presence particularly in strategic locations through funding infrastructure projects (Murphy, 2017).

Samaranayake and Rajapaksha (2015) identified this critical shift and relates it to the strong Chinese presence in Sri Lanka resulted due to change of the landscape of external debt. It was identified that China uses 'its aid – the dragon kiss' to cripple the intensity for better cooperation along with the neighboring states. On the other hand, Kahandawaarachchi (2015) argues that South Asian countries perceive China as a counter balance against the regional hegemony of India, based on their own reasons and domestic political concerns. Hence, this study reviews the hypothesis of China using Sri Lanka as a proxy state, with concerns to the potential geopolitical fluxes.

In light of the rise of china's economic presence in Sri Lanka, this study attempts to analyze the scenario in a political economy perspective. The study attempts to quantify the extent of Chinese economic presence in Sri Lanka and to what extent it had influenced the country economically as well as geo-politically.

### **Methodology**

The study adopts descriptive analyzes approach to quantify the Chinese economic presence in Sri Lanka. While using International Monetary Fund (IMF) indicators

relating to external debt sustainability, the study relates such indicators to identify the impact that China had on Sri Lanka's external debt sustainability. These descriptive statistics as well as the indicators are then further analyzed using existing political economy theories. In this respect, the hypothesis of China using Sri Lanka as a proxy state was tested using relevant comparisons which indicates the rise of Chinese economic presence of the region and was attempt to examine the concept of 'Debt trap diplomacy' in relation to China's economic presence in the island nation using available data. Secondary data obtained from External Resource Department (ERD) and the Central Bank of Sri Lanka are used for the analysis.

### Results and discussion

More often than not, external borrowings is not merely an economic concern, but a political and geopolitical concern too. Sometimes, it is a matter of compromising national interest for the short term economic survival, maybe even risking the geopolitical power balances. The statistics regarding the external borrowing indicate that borrowings from China has increased significantly, and substantial percentage of borrowings are non-concessionary obtain from EXIM Bank, China. According to ERD Annual Reports total loan commitments from China during 2008-2012 was US\$ 3,609 million. During the same period, total amount of external borrowings obtained were US\$ 6149 million. This clearly indicates the strong reliance on Chinese loans, which amounts to 59 percent of total external borrowings obtained from 2008-2012. It is also evident that China was not amongst the major donors to Sri Lanka till 2007 and during next 4 years dynamics changes rapidly and by 2016 Chinese loans amounted to 13 percent of the total debt stock (USD 25.3 Billion), significant part of which obtained at a higher interest rate and invest in strategic assets.

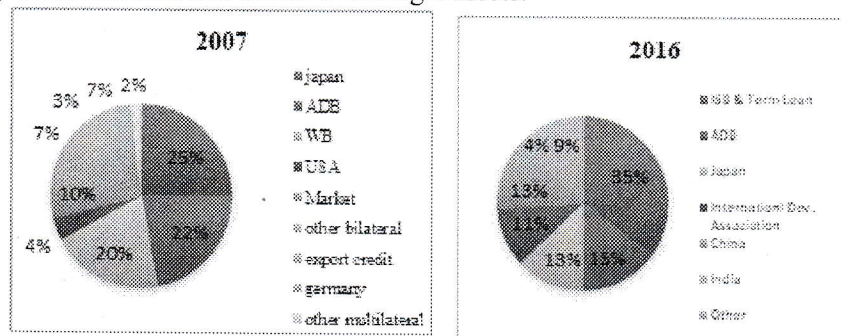


Figure 1 Sources of External Borrowing-Comparison of 2007 & 2016

Source: External Resource Department

The consequences of this scenario was examined by Samaranayake and Rajapaksha (2015) who concluded that allowing Chinese aid to dominates the



post war development strategy in Sri Lanka, provided an easy access for China to manipulate Sri Lankan strategies and uses Sri Lanka as a cats' paw state expand its power and establish the presence in the South Asian region.

**Table 1** Borrowings from China (2011-2016)

		Growth of Chinese Debt (US\$ Mn)					
<i>Bilateral</i>		2011	2012	2013	2014	2015	2016
Disbursed	Outstanding	102.3	334.5	499.1	688.7	829.5	885.7
Debt							
Principal Repayments		3	2	13.8	51	51	70.9
Total Debt Service		6.8	21.2	44.3	83.8	91.7	113.1
<i>Export Credit</i>							
Disbursed	Outstanding	1788.7	2401.6	3257.6	3614.6	3691.1	3756.6
Debt							
Principal Repayments		12.9	24.2	34.2	99.4	197.6	232.7
Interest Payments		44	58.6	75	93.8	101.4	99.8
Total Debt Service		56.9	82.8	109.2	193.3	299	332.5
<i>TOTAL</i>							
Disbursed	Outstanding	1891.1	2736.2	3756.6	4303.3	4520.6	4642.4
Debt							
Principal Repayments		15.9	26.3	48	150.5	248.6	303.6
Interest Payments		47.8	77.8	105.6	126.6	142.1	142
Total Debt Service		63.7	104	153.6	277.1	390.7	445.6

Source: External Resource Department

The decision of China to finance the development in Sri Lanka is very much in line with its national interest of enhancing regional power and strengthening the One Belt One Road initiative<sup>27</sup>. Literature observes that China attempts to establish strong presence through getting access to strategic assets of countries which would connect the one belt one road initiative. It is evident that infrastructure alliances are not a one-way street, hence such assets located in foreign soil can be expropriated. In that context, Sri Lanka was studied as a case study in relation to China's role involvement in developing ports in the country. China's so-called "String of Pearls" strategy has been to develop maritime access points on either side of India, such as Myanmar's Mada'ya Island, Sri Lanka's Hambantota Port, and Pakistan's Gwadar.

The geopolitical interest of China can be identified through closely analyzing the data regarding the projects on which Chinese borrowings were utilized. Most of the Chinese loans were used to construct strategic assets such as power plants, a port and airport as opposed to education or rural development projects financed

<sup>27</sup> An economic roadmap explores the economic topography of seven global regions.

by international donor agencies such as World Bank. It should also be noted that most of the Chinese aid were term loans, provided through the EXIM Bank, for which conditions were attached regarding the way in which such loans are utilized. There, an important distinction can be drawn between sovereign bonds and bi-lateral loans obtained, particularly from China. Raising dollars through sovereign bonds gives autonomy to the government regarding way in which such borrowings are utilized as opposed to the conditions imposed when bi-lateral loans are obtained.

Data precisely show as increase of borrowings from China, particularly borrowings obtained through export credit lines for which many terms and conditions are attached. This can be identified as phenomena of China using economic diplomacy discussed in a study by Bayne and Woolcock (2007). The study observes that China expands the potential number of national and systemic players with economic interests and responsibilities in the diplomatic process using economic diplomacy.

Empirical evidence shows that Chinese loans are invested in strategic projects which would help them to enhance the regional power and use small states as cats' paw states. During the period of 2008-2012 highest commitment of US\$ 618 million or 37 percent of total Chinese borrowings were utilized to improve the development of Port facilities. The Government of China through an export credit facility has committed US\$ 307 million for the Hambantota Sea Port Development Project.

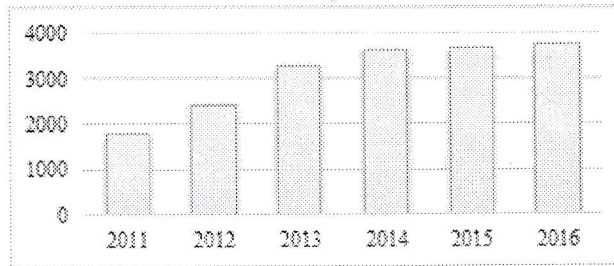
**Table 2** Rise of Debt servicing cost for China

Year	Debt Servicing to China (US\$ Mn)	Debt Servicing (US\$ Mn)	China debt servicing/ Total debt Servicing
2011	63.7	1513.6	4.2%
2012	104	2228.6	4.7%
2013	153.6	2417.7	6.4%
2014	277.1	2288.4	12.1%
2015	390.7	2940.1	13.3%

*Source: Estimations based on ERD data*

Further, out of total Chinese borrowings large share was spent on projects relating to port development and energy sector development, which are strategic assets. The projects in which Chinese borrowings were utilized are very different from the projects in which borrowings from donors such as World Bank and ADB, as substantial part of those borrowings were utilized for developing roads and bridges, education projects and rural development. According to the ERD data, during the period of 2008-2012, out of Chinese loans 23 percent was spent on ports, 31 percent in energy sector and 6 percent on aviation. These loans had

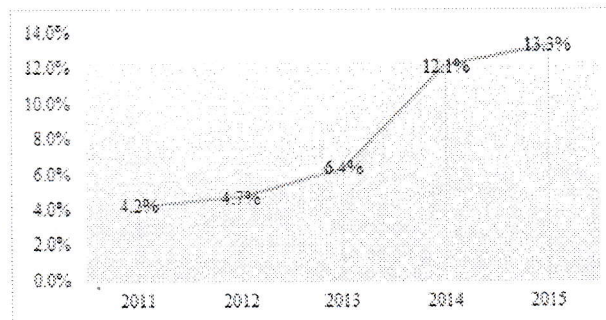
terms and conditions, and most recently Sri Lankan government was pushed to consider the option of using Hambantota port as a joint venture with China due to the mounted pressure due to the rapid increase of external debt servicing payments.



**Figure 2** Export credit obtained from China (US\$ Mn)

*Source: Authors' estimations based on ERD data*

Chellaney terms this phenomenon as 'Debt Trap Diplomacy' where the significant geopolitical power of a country is obtained using economic power. Studies of Chellaney identifies that china is truly excel, it is the use of economic tools to advance their country's geostrategic interests. It was identified that US\$ 1 trillion 'one belt, one road' initiative, China is supporting infrastructure projects in strategically located developing countries, often by extending huge loans to their governments. It was further observed that projects funded by China are majorly aimed at serving China's interest, instead of prioritizing the development of local economy. Chellaney, in his studies notes China's terms go to the extent of utilizing their constructions workers instead of local workers minimizing the benefits received by respective countries.



**Figure 3** Chinese debt servicing cost as % of total debt servicing cost

*Source: Authors' estimations based on ERD data*

Serving the national interest of China in the expense of obtaining debt to develop infrastructure had created power imbalance in the region. Experts argue that India rose concerned by strong Chinese presence established through using the economic power of china had concerned India. Reseach argued that China's attempt to establish the dominance in the region was evident looking at the way



in which India reacted when Chinese Submarine visited Colombo port. However, Chinese influenced continue to grow and it appears that country had got caught in Chinese debt trap diplomacy. China had already located themselves in two of the most valued strategic locations, Hambanota and Colombo. This in turn had appeared to antagonize India, who signed an MOU with Sri Lanka which includes developing Trincomlee Port. Sequence of events indicates that many geopolitical challenges are ahead of Sri Lanka in terms of balancing the act arose as a result of getting caught in China's debt trap diplomacy.

### **Conclusion**

Analysis conducted regarding sources of external debt during 2005-2016 it was evident that China had become the major source of obtaining debt. It was identified that most of the Chinese loans were commercial loans which obtained through export credit lines. It was also identified that most of Chinese borrowings consisted of conditions, thereby recognized as term loans and it is concluded that China had used Sri Lanka to promote its national interest of establishing its power in South Asian region. Through massive commercial debts provided, China in a way had captured Sri Lanka in a debt trap. Further, Chinese debts were invested in developing strategic locations of the country giving some control of those to China. The strategy of China to establish power in South Asian region through economic diplomacy was closely observed by India, and the concerns raised by India had put Sri Lankan government between devil and the deep blue sea.

**Keywords:** *Chinese borrowings, Debt-trap, economic diplomacy, geopolitics.*

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