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## Sri Lanka China Economic Relations based on Chinese Investments in Sri Lanka 中国在斯里兰卡投资中斯中经济关系研究

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### Abstract

Sri Lanka and China have strong bilateral ties since historical times. Though many historical records describe Sri Lanka and China as well-developed countries in the past, currently Sri Lanka is named as a lower-middle income country. In contrast to that, China is soon becoming an economic supremacy in the world. As a method of increasing Chinese soft power globally, China offers a large number of investments to developing countries that could benefit China in their long-term goal of gaining the economic and political supremacy. Hence, China has identified several reasons for investing in Sri Lanka that could benefit both countries. One such reason is the geo-strategic location of Sri Lanka which has a high potential of converting to a trade hub in the future. Through the “Belt and Road initiative”, Sino-Sri Lanka relations have further strengthened during the past decade. Despite such initiatives, the Chinese investment inflows to Sri Lanka are looked at from different perspectives. Using the qualitative method, especially with inductive analysis, this research identifies the economic benefits that can be gained through the bilateral relations and the positive impacts of recent Chinese investments in Sri Lanka. Moreover, as Sri Lanka has a high potential of attracting further investments in the future, referring to scholarly materials, the researcher will suggest several measures that can be taken to enhance investment opportunities and economic ties between the two countries.

**Keywords:** Chinese Investments, Potential Benefits, Positivity, Sri Lanka-China relations.

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### Introduction

With the end of civil war in 2009, Sri Lanka’s fate has changed for the better. By 2010, the Sri Lankan economy recorded an impressive growth of 8 percent (Premaratne, 2011). As in other Asian countries who are looking toward Chinese investment opportunities, Sri Lanka is also trying to create strong economic

relations with China. However, from the ancient times itself, China and Sri Lanka had positive ties (Bastiampillai, 1990). Networking with China further developed in the mid-1990s. Due to this strong friendship and cooperation between the two countries, China has supported Sri Lanka when Sri Lanka was in real need. Examples of such support include the aid

received during the Tsunami disaster and the civil war in order to reconstruct the destructed areas. Furthermore, Chinese investments and trade opportunities started flowing into the country with the project “The Belt & Road initiative”. The Geostrategic location of Sri Lanka has always won the interest of China as the most important shipping lines to China pass across the Sri Lankan maritime territory (Deysappriya, 2016). Furthermore, China has identified Sri Lanka as a potential location to become a trade hub in the future that could connect the Asia-Pacific region with the Gulf, African, and European Regions. These reasons have made China willingly invest in Sri Lanka in order to keep strong and friendly bilateral relations that could be more advantageous in the future.

The Hambantota port will further enable access across the Indian Ocean, stretching to the far East, to Europe, and across the globe. Sri Lanka will be well positioned to play a strategic role in the One Belt One Road initiative of the government of People’s Republic of China - by Hu Jianhua (China’s merchant executive vice president) (news, 2017).

### **Chinese Investment in Sri Lanka**

Due to the civil war, Sri Lanka lost many opportunities for development. The most critical time for Sri Lanka came during the last phase of the war which started from 2005 to 2009. However due to instability of the government, insecurity of the business environment, and the unpredictability of the future, Sri Lanka could receive very few foreign investment opportunities. As a result of that, FDI (Foreign Direct Investment) inflows from China to Sri Lanka were also reduced until 2008. Hence, from

2003-2008, it has only counted for USD\$ 61.7 million (Samaranayake, 2011).

However, with the end of the civil war in 2009, the former president Mahinda Rajapakse’s government implemented a vast number of projects across the country; especially in the under developed areas like Hambantota with Chinese government support. It has also helped to strengthen the relations between the two countries. Moreover, with the gradual implementation of investment projects all around the country, China became the key sponsor for Mega infrastructure development projects in Sri Lanka.

After the civil war in 2009, Sri Lanka was in extreme need of infrastructure development due to the mass destruction that took place for 30 years. Sri Lanka had to rebuild the destroyed buildings, roads, railways, irrigation systems, and build housing complexes for the war victims. However, due to high expenses for security purposes, the Sri Lankan government was in a serious economic crisis with little available resources to allocate a budget for development of the country. Thus, Sri Lanka had to invite and request foreigners to invest in the country.

Beside this situation, the Sri Lankan government has also undergone many challenges in the post war period. With the end of the war, international Organizations started to accuse the Sri Lankan government of war crimes and violating Human rights (BBCNews, 2011). Due to Sri Lanka’s tarnished reputation, and other security and trust issues, most international investors and organizations had lot of pre-conditions and restrictions (Deysappriya, 2017). One of the best examples is the Economic and Technological Cooperation Agreement (ETCA) which Sri Lanka hesitated to sign (Economic and Technological Cooperation Agreement (ETCA),

2017). Therefore, at some points Sri Lanka was less benefited or merely trapped. As an alternative option, Sri Lanka then turned to get the support of its regional powers like India and China, but were, however, unable to gain the expected support. Moreover, Sri Lanka lost many World Bank loans and International Monetary Fund (IMF) aid when it reached the level of a lower-middle income country (Deyshappriya, 2016). At a critical time like that, Sri Lanka was assisted by China to continue its development plans. Furthermore, Sri Lanka was seeking fast loans, assistance, and support with the least pre-requisites, conditions or any restrictions, and it was only Chinese offers that fit with Sri Lanka's requirements (Deyshappriya, 2016). This finally resulted in China becoming the top investor in Sri Lanka. "China's aid to Sri Lanka jumped from a few million dollars in 2005 to almost one billion dollars last year (2008), replacing Japan as the biggest foreign donor" – Times of London, May 2009 (Samaranayake, 2011).

Sri Lanka and China found a common interest and strengthened their relations through investments. China has not just become the most trusted and the largest investor in Sri Lanka, but also provided assistance to rebuild the country after the war. Thus, China has invested much on infrastructure development projects than any other country. From the Chinese perspective, China understood the importance of Sri Lanka for their future global trade. Therefore, China focused much on harbours, ports, and airports in addition to developing the roads and energy sector in Sri Lanka. The strengthened relationships between the two countries led China to start mega investments projects in Sri Lanka.

According to MOF (2013) China became Sri Lanka's largest lender in 2009 and 2010, investing US\$ 1.2

billion and US\$ 821 million respectively. It has accounted as 54% in 2009 while it has accounted as 25% in 2010. In 2011 also China became the largest financier for Sri Lanka giving US\$ 760 million loan even surpassing Japan's US\$ 413 million and US\$ 105 million from the World Bank (Silva, China tops Sri Lanka loan commitments, 2011) Further to that, in June 2011, China Development Bank has agreed to sponsor infrastructure projects for the next 3 years in Sri Lanka with US\$1.5 billion (Silva, Sri Lanka to get US\$1.5bn from China bank, 2011).

Thus, up to 2011, China has made a lot of investments in Sri Lanka such as: Norochchola Power Plant, Southern Expressway, Mattala Rajapaksa International Airport, Hambantota Harbor Project, Nelum Pokuna (Lotus Pond) theatre, Lotus Tower, Colombo Port City Project, Moragahakanda-Kaluganga development project, Mahinda Rajapaksa National Tele Cinema Park, Mahinda Rajapaksa International Cricket Stadium, Exclusive Economic Zone, Mirigama, Colombo Katunayake Express way, Rebuilding of Northern roads and many similar projects (Central Bank of Sri Lanka, 2005-2015).

These significant investment projects started in Sri Lanka gained the international attention of those who were doubting the Chinese power establishment within Sri Lanka. However, it is worth mentioning that China's interference in local affairs of the Government of Sri Lanka is minimal. "We do not seek to simply transfer aid to host countries like Sri Lanka, but we hope to help them improve their economic opportunities and ours too. It is not a donor-recipient relationship, but win-win economic co-operation" (Wheeler, 2011).

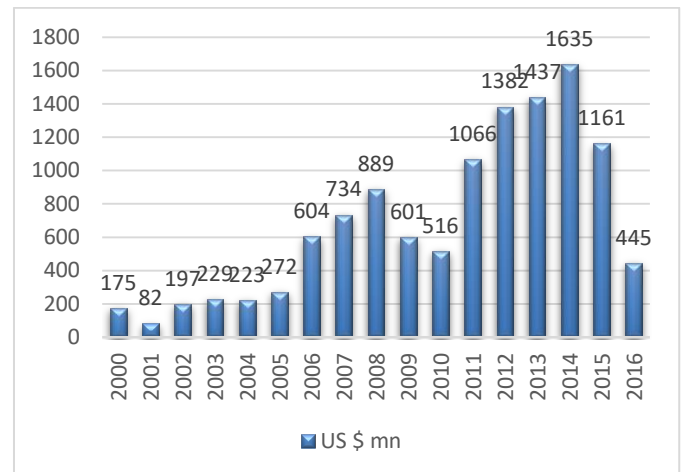
Further, there was a high improvement of Chinese investments after 2011 which resulted in China

surpassing India who was the top investor Sri Lanka. President Rajapakse's relationships with the Chinese Government than with India and western powers as well as Indian prejudices against Sri Lanka after the civil war were the main reasons behind China being the top investor in Sri Lanka.

The data derived from board of investment reports (2011-2014) indicates that Chinese investments in Sri Lanka has drastically increased after 2011. China even surpassed India in 2012. Moreover, China then became the 3<sup>rd</sup> largest FDI donor in Sri Lanka by 2012. According to reports, the FDI to Sri Lanka was US\$ 185 million. However, it is also seen that the FDI from both Hong Kong and United Arab Emirates has gone down from 2012, while Chinese investments have increased drastically and brought US\$ 403 million FDI by 2014. With this rapid increment of Chinese investments, China became Sri Lanka's largest donor by 2014. As a share, it is 24.53% of the total FDI to Sri Lanka in 2014. Further this rapid growth is indicated as 117.84% of the growing rate of investments to Sri Lanka (BOI, 2011-2016) as cited in (Deyshappriya, 2016). These investments are mainly focused on Infrastructure development, energy and power, telecommunication, garments, and electric manufacturing sectors in Sri Lanka.

The government of Sri Lanka from 2005-2015 was under the president Mahinda Rajapakse who maintained close relations with China. Thus, in this period, the Sri Lankan government successfully obtained investments from China. Nevertheless, the change of government in 2015 significantly affected the bilateral relations between the two countries. The former president Maithreepala Sirisena, who came to power after president Rajapakse made significant changes in the government and even presidential

powers. Compared to the former government, President Sirisena and Prime Minister Ranil Wickramasinghe have been slightly pro-Western at the beginning of the government. As a result of that, the new government tried to cut-off so many Chinese investment projects that have been implemented by the previous government (Barry, 2015). They have even stopped the on-going mega projects at that time without identifying the long-term consequences. Because by this time, China has been the largest investor as well as the donor to Sri Lanka. When the Chinese investments were cut-off, it could not be covered by other investors as there was a high gap between Chinese investments and other foreign investments to Sri Lanka. Thus, the total FDI that increased to US\$ 1,635 million by 2014 drastically reduced to US\$ 1,161 million by the end of 2015. However, it became even worse by the next year (2016) where it has even gone down to US\$ 445 million letting the country under an economic crisis as well as high debts (CBSL, 2000-2016).



**Table 1 Foreign Direct Investment Inflows**

The main reason for the downfall of these investments can be identified as the loss of Chinese investments. Because, President Sirisena's government has cut-off most of the mega projects planned by China. The best

example is the “Colombo Port City Project” (Reuters, 2016).

However, the new government understood the mistake done by cutting-off Chinese Investments. It was not easy to develop the country without Chinese Investments because Sri Lanka was highly depending on Chinese Investments. Although the President Sirisena’s government had more expectations about west and their support than from China, Sri Lanka didn’t get the expected support from west (Goodhand & Walton, 2017). Hence, Sri Lanka lost lot of investments that has never even had during the most critical time of the war after 2005.

Understanding the situation, Sri Lanka changed their policy and decided to become a founding member of AIIB in 2016 and to re-continue the Chinese investments with a new phase. Thus, the former agreements were renewed and signed to re-continue the investments. Therefore, not only continuation of half-done projects, but also new projects have started with the invitation by the Sri Lankan government for further investments.

As a result of that, in 2017 even surpassing India who was once the top investors in Sri Lanka, China has accounted for 35% of foreign direct investments (FDI) into Sri Lanka according to the Ministry of Development Strategies and International Trade in Sri Lanka. Hence, by the end of 2017 FDI inflows has reached up to \$1.37 billion (World Bank). As Ministry of Development Strategies and International Trade states, “Data from the Board of Investment indicates Sri Lanka; a substantial uptick in FDI inflows has been recognized to the country of \$795.5 million during January to September in 2017, which is 80 % higher than the same period in 2016 and already exceeding the full year 2016” (ChinaDaily, 2017).

Due to further investment projects by China, the FDI has increased up to \$1.61 billion by 2018 (World Bank). Nevertheless, due to Easter bomb attack, FDI flows to Sri Lanka have decreased from \$1.6 billion in 2018 to \$758 million in 2019. (UNCTAD, 2020). Despite of this downfall due to terror attacks and Covid-19 pandemic issues, the current government is expecting to attract \$4 billion FDI to Sri Lanka by 2022 (Sri Lanka: Country Risk, 2020).

When considering the FDI inflows, China (with Hong Kong) ranks first throughout this period, India and Singapore rank second and third respectively in the top investing countries in Sri Lanka. Moreover, a distinctive gap between Chinese investments and the rest is significant. Hence, it can be assumed that China would be the top investor to Sri Lanka even in the future. Therefore, maintaining friendly relations with China is extremely important to Sri Lanka.

### **Why Sri Lanka prefers Chinese investments? (From the perspective of Sri Lanka)**

Sri Lanka has borrowed a considerable amount of loans from China. Thus, Sri Lanka is in high debts to China. Despite this, Sri Lanka still prioritizes Chinese investments.

As a small economy recovering from terrorism, investments are crucial to develop the country’s economy. Nevertheless, it is not an easy task to develop the country without international support. In order to achieve its targets, Sri Lanka needs the support from economically stable countries. Thus, accepting Chinese FDI it is one of the remaining best options. China’s confidence to invest in economically unstable countries compared to Westerners is worth noting. By helping economically unstable countries to develop, China creates strong ties with them. By

establishing good relations around the world, China would be stronger both economically and politically. Nevertheless, some scholars even from Oxford and Cambridge argue that Chinese investments can affect Sri Lanka negatively due high debts resulted of borrowing billions of dollars to build domestic infrastructure during the former government (Goh, 2016) & (Pathirana, 2020). By 2017, Sri Lanka's estimated national debt was US\$ 64.9 billion, of which US\$ 8 billion is owed to China. Further Sri Lanka borrowed US\$ 301 million from China with an interest rate of 6.3 per cent, while the interest rates on soft loans from the World Bank and the Asian Development Bank (ADB) were only 0.25–3 per cent. (Veasna Var, 2017). As a consequence of that, now Sri Lanka undergoes a critical condition where it is impossible to repay the debts as the economic growth of the country is comparatively slow. Thus, Sri Lanka has converted these debts into equity by handing over 80% of the total share of Hambanthta port for 99 years to China (Veasna Var, 2017). The same issue has happened with the Mattala Airport which was built with \$300–400 million Chinese loans. It was difficult for Sri Lanka to maintain its expense which costs around US\$ 100-200 million annually (Veasna Var, 2017). In addition to these projects that have already completed, there are some on-going projects that created a debate among Sri Lankans. The Colombo Port City project which costs around \$1.4 billion is one of them.

Although majority accuse China for the debts Sri Lanka undergoes, it is important to understand that Sri Lanka should be more responsible for the debts than China. If these valuable opportunities are used in the right manner being more accountable, the situation could have been different. This was also stated by the

former president Sirisena during his visit to Beijing after being elected as the president “the current problems facing the Colombo Port City project are temporary and the problems do not lie with China”. Chinese President Xi Jinping in return expressed his hope that “Sri Lanka could ensure the legitimate rights and interests of Chinese enterprises” (Xi Jinping Holds Talks with President Maithripala Sirisena of Sri Lanka, 2015).

Furthermore, it is often seen that the opposition political parties to the government always try to antagonize the public creating a negative impression about China with the intention of elasticizing their political career. However, they have been successful in their intention to a significant level and a tunnel view among certain communities. Thus, some people have misunderstood the Chinese investments as a conspiracy of selling Sri Lanka to China.

In spite of above-mentioned issues that Sri Lanka under goes, it still has the hopes and ambitions of becoming a trading centre for Asia, especially Sri Lanka wants to be the trading hub in the Indian ocean that could connect both east and west. With this intention, the Sri Lankan government tries to follow the Singapore's model of development in order to leverage its geographic position in the centre of the Indian Ocean. Thus, Sri Lanka needs to restore the economic and political stability to gain further foreign opportunities. As a country with a very high literacy rate, educated workforce, attractive destination with geo-strategic values, Sri Lanka has a high potential of developing if corruption and economic instability can be reduced. Especially at a time China offers investment opportunities through Belt and Road initiative. With the support of China, Sri Lanka can advance its port and border shipping service industry



to build up the economy as in the Singapore model; not only the Colombo port (the biggest transshipment hub in South Asia) but even the Hambantota port can be turned into a trading hub important for the entire world. However, it is the responsibility of the government to take the important measures to develop the shipping industry of the country.

According to Sri Lankan former Central Bank Governor Dr. Indrajit Coomaraswamy, China offers unparalleled opportunities for Sri Lanka with pending FTA and Belt and Road Initiative that creates a strong platform for trade investments. It could also bring solutions to labour restrictions.

Stronger economic relations with China, underpinned by a pending Free Trade Agreement (FTA), should be given the highest priority by Sri Lanka as it provided the best opportunity to attract trade investments and implement important structural transformations in the economy. No other country offers anything as much in terms of capital which is able to be deployed from China. In addition to that, China has been a longstanding and steady friend of this country. Having said that, relations with China must always be given the highest right by Dr. Coomaraswamy. (Jayawardena, 2018).

In addition to the above facts, he also pointed out that Chinese FTA has the potential to increase the market access to Sri Lankan exports to China making a transformative impact on investment and technology in Sri Lanka. Accordingly, that structural changes within Sri Lanka's economy should be encouraged by Chinese investments, with more labour reform over agriculture and other underproductive sectors that could filter into better paying industries and services sector jobs. In supporting the Chinese investments, if Sri Lanka can provide the suitable land and labour

force for these investments, it could develop the infrastructure of the country as well as bring opportunities to labour force in the country.

Another reason for Sri Lanka to prefer Chinese investments is the non-interference in the local affairs of the country. Soon after the war, Sri Lanka invited many powerful nations to invest in Sri Lanka. But majority of investments came as a package of unbearable pre-conditions that were highly interfering the local affairs of the government. One of the best examples is the Millennium Challenge Corporation (MCC) compact which wanted to interfere the local matters by reshaping the laws and institutional framework of the local affairs of Sri Lanka (Bandarage, 2020). Such incidents disappointed Sri Lanka about many international investors as they were trying to fulfil different intentions. Meanwhile, Chinese foreign policy of non-interference in to local matters of trading countries is highly preferred by Sri Lanka. Therefore, China became a good investor and also a strength to Sri Lanka.

Moreover, China's rapid growth of investments made Sri Lanka more confident to open up with China. China has started to invest in Sri Lanka continuously since 2000s. By 2005, Chinese FDI was just few millions and it has turned out to be billions by 2017 with a 117% of rapid growth of investment (Ganeshan Wignaraja, Dinusha Panditaratne, Pabasara Kannangara, & Divya Hundlani, 2020). Also, China has become the top investor for Sri Lanka within very few years while Sri Lankan government became more confident about Chinese loans and investments. Especially as the main stakeholders are more flexible and stable like: Export-Import Bank of China, China Development Bank Corporation, Chinese State-owned Bank and Government of China.

### **Suggestions to improve Chinese Foreign Direct Investments**

Though China is the top investor to Sri Lanka currently, Sri Lanka could still increase the potential benefits by increasing the foreign direct investment inflows coming from all around the world. Therefore, suggestions can be presented referring to scholarly materials (Deysappriy, 2017) .

Firstly, it is important to improve the transparency of the legal system in order to create confidence among foreign investors. This will eventually help to strengthen international rankings regarding a better image about the country. As far as the impression about the country develops internationally, FDI will also increase gradually.

Moreover, Sri Lanka should Strengthen the relationship with international banks like Asian Infrastructure Investment Bank (AIIB) that support the development of developing countries.

Investor friendly atmosphere is very important for a country to gain international investments. Hence, creating such an environment is crucial. Being more flexible and opening up with foreign investors, especially with taxation, investment policies and visas are crucial to attract more investors. While inviting other countries to invest in Sri Lanka, it is also important to strengthen the relations with already existing top investors.

The reference information systems to investments in Sri Lanka should always be attractive and user-friendly. Hence, Sri Lankan business and investments websites, and marketing and promotion pages should be highly pleasing and should be facilitated in multiple languages, especially in Chinese language.

Additionally, more opportunities should be given to talented Sri Lankan students to learn in China and

both governments should take their skill service as they are more familiar with both environment and languages.

### **China Sri Lanka economic relations from the perspective of international relations**

According to the theories of International Relations, China Sri Lanka economic relations can be described using concept of liberalism. Both countries have their own ambitions. China wants to be the economic super power in the world emerging as a peaceful soft power. On the other hand, Sri Lanka wants to recover from the impacts of war and economic crisis that the country is undergoing for a long period. Furthermore, Sri Lanka has an ambition of developing the country as an international hub like Singapore because it has the potential and a geostrategic location. Although the ambitions of the two countries do not clash with each others, they have a shared interest of gaining their maximum development. Therefore, both countries have started cooperating in order achieve their own interests. Both countries have a collective effort where China helps to develop Sri Lanka while Sri Lanka helps China to strengthen their trade to Gulf, Africa and Europe being a trade hub in the Indian Ocean. This interdependency over the mutual benefits has made Sino-Sri Lanka bilateral relations stronger and friendlier. Therefore, both countries see their cooperation as a win-win to both nations. Chinese policy of “Non-Interference” and “Peaceful Coexistence” has also brought more confidence for Sri Lanka. Further, from the Sri Lankan perspective, China is not seen as an intervener for the local matters of the country. Moreover, Sri Lanka as a less powerful country, the smartest decision it can take is not to compete with the most powerful nations in Asia



but to harmoniously cooperate with them for the benefit of the country.

### Conclusion

Sri Lanka is a very small country in the world that has been struggling to develop its economy by overcoming the impacts of the 30 years of civil war. Thus, China who had its interest over Sri Lanka started investing in Sri Lanka when it was in real need. As a result of the rapid growth of Chinese FDI to Sri Lanka, China has now become Sri Lanka's top investor. Although there is a risk of debts, the investment opportunities offered to Sri Lanka will however have a positive impact for a rapid economic development of the country. Due to incomparable Chinese investments offered to Sri Lanka, it is clearly seen that Sri Lanka is highly dependent on Chinese investments. Strengthening the Sino-Sri Lanka bilateral relations is directly connected with the economic development of the country.

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