Along the road
Sri Lanka's tale of two ports

by Plamen Tonchev

In December 2017, Sri Lanka formally handed over the southern sea port of Hambantota to China on a 99-year lease. It is not unique: another mega-project, known as the Colombo Port City, is currently underway in Sri Lanka's capital, and a large part of the area is also subject to a 99-year lease held by a Chinese state-owned enterprise (SOE).

These two cases are crucial parts of a network of important access points in the Indian Ocean acquired by China, which help it avoid the Strait of Malacca – identified as a strategic chokepoint by former President Hu Jintao back in 2003. In addition to China's dependence on maritime trade, access to the Indian Ocean without having to go through the Strait links China's landlocked western provinces to a network of supply routes for strategically important commodities, and shaves off thousands of miles of travel at sea. This is the main reason for the ever-growing Chinese presence on the shores of the Indian Ocean, including in Sri Lanka, as part of its Belt & Road Initiative (BRI).

China in Sri Lanka

Clearly, Sri Lanka's biggest asset in this regard is its very location. The island nation straddles a strategically important shipping lane, which is deemed the busiest trade route in the world. Some 64% of the global oil trade passes through the Indian Ocean and China alone imports nearly two-thirds of its oil through this maritime corridor. In addition, China is heavily reliant on these shipping lanes for the export of its commodities to Europe and Africa. Equally importantly, Sri Lanka has one geographic attribute its South Asian neighbours lack – a coastline conducive to building large, deepwater ports able to handle the world's largest ships.[1] Finally, as the third largest body of water in the world, the Indian Ocean itself contains considerable natural resources.

Sri Lanka lies roughly in the middle between China and the Mediterranean Sea. Hambantota is 4,213 nautical miles away from Shanghai and 3,371 nautical miles from Shenzhen, and it would take containerships 10 and 8 days, respectively, to reach the island (moving at the usual average speed of 17 knots). They would then spend a further 10 days travelling to the Suez port in Egypt, which is 3,862 nautical miles away. Moreover, Hambantota is also (relatively) close to the Kenyan port of Mombasa (2,807 nautical miles), a gateway to east and central Africa and another key focus point of BRI-related activities.

Thanks to its location, Sri Lanka is well-suited to provide the facilities for urgent crew changes, medical evacuation, bunkering operations and the re-supply of provisions. The leased port will be able to handle dry cargo, roll-on roll-off (ro-ro) vessels transporting trucks and automobiles, oil tankers, as well as gigantic 400-metre container ships. A $3 billion oil refining facility is to be built and operated by either Sinopec or China Petroleum, while a large cement factory is also to be constructed, and Chinese manufacturing and logistics companies are already planning to begin operations on the island.[2]

It is expected that Hambantota will help lower prices and improve supply chains across the entire region, and thus contribute to considerable growth in trade volumes. Furthermore, in view of a canal that is currently being planned to run across southern Thailand, Hambantota's significance is likely to increase in the future. This megaproject would slash approximately 1,200 miles off the sea route from Suez to China and re-direct business away from the Malacca Strait and Singapore.

Chinese companies completed the construction of the Hambantota deep sea port in 2012 at an estimated cost of $450 million. Under the recent deal between Colombo and Beijing, the so-called Hambantota International Port Group (HIPG) and Hambantota International Port Services (HIPS), overseen by the China Merchants Port Holdings Company (CMPort) and the Sri Lanka Ports Authority, will own the port and the adjacent 5,000-acre investment zone. The state-run conglomerate CMPort, the largest port owner and operator in China, is to invest up to $1.1 billion in the port and additional facilities. The special economic zone was created at the request of Beijing, with the promise of further Chinese investment in return.

The Colombo Port City, the largest single example of foreign direct investment in Sri Lanka to date, is a $1.4 billion deal – backed financially by the China Harbour Engineering Corporation – to reclaim 568 acres of land. The new site is envisaged to become a modern city with towering skyscrapers, luxury hotels, shopping malls, a marina, embassies, healthcare and educational institutions, as well as other facilities. The project has now been renamed the Colombo International Financial City (CIFC) and it is estimated to be a $15 billion investment upon completion. Notably, the grandiose commencement ceremony in September 2014 was attended by both then Sri Lankan President Mahinda Rajapaksa and Chinese President Xi Jinping.[3]

While Hambantota is to become the main Chinese-operated transhipment hub in the Indian Ocean, the port in Colombo will probably handle cargo destined mainly for Sri Lanka's domestic market. However, the CIFC project is being designed with a different type of connectivity-related activity in mind. It is expected to become an offshore financial centre, one that meets increasingly sophisticated requirements and is likely to attract international corporations which are keen to establish their regional headquarters in Colombo. Sri Lanka is located in a convenient time zone, midway between the world's major financial markets: Tokyo, Hong Kong and Sydney to the east, and New York, London and Frankfurt to the west. When eastern markets close for the day, Sri Lankan-based companies could handle overnight financial transactions; once Colombo closes, operations could be transferred to hubs to the west.

How China got in

It took Beijing about a decade to make inroads into Sri Lanka, against a difficult political and economic background and in the face of a complex combination of domestic politics and regional geopolitics. May 2009 saw the brutal end of the protracted conflict between the central government and the Liberation Tigers of Tamil Eelam, which led to Colombo's estrangement from the West. China was quick to position itself as Sri Lanka's key ally by providing military and development assistance.

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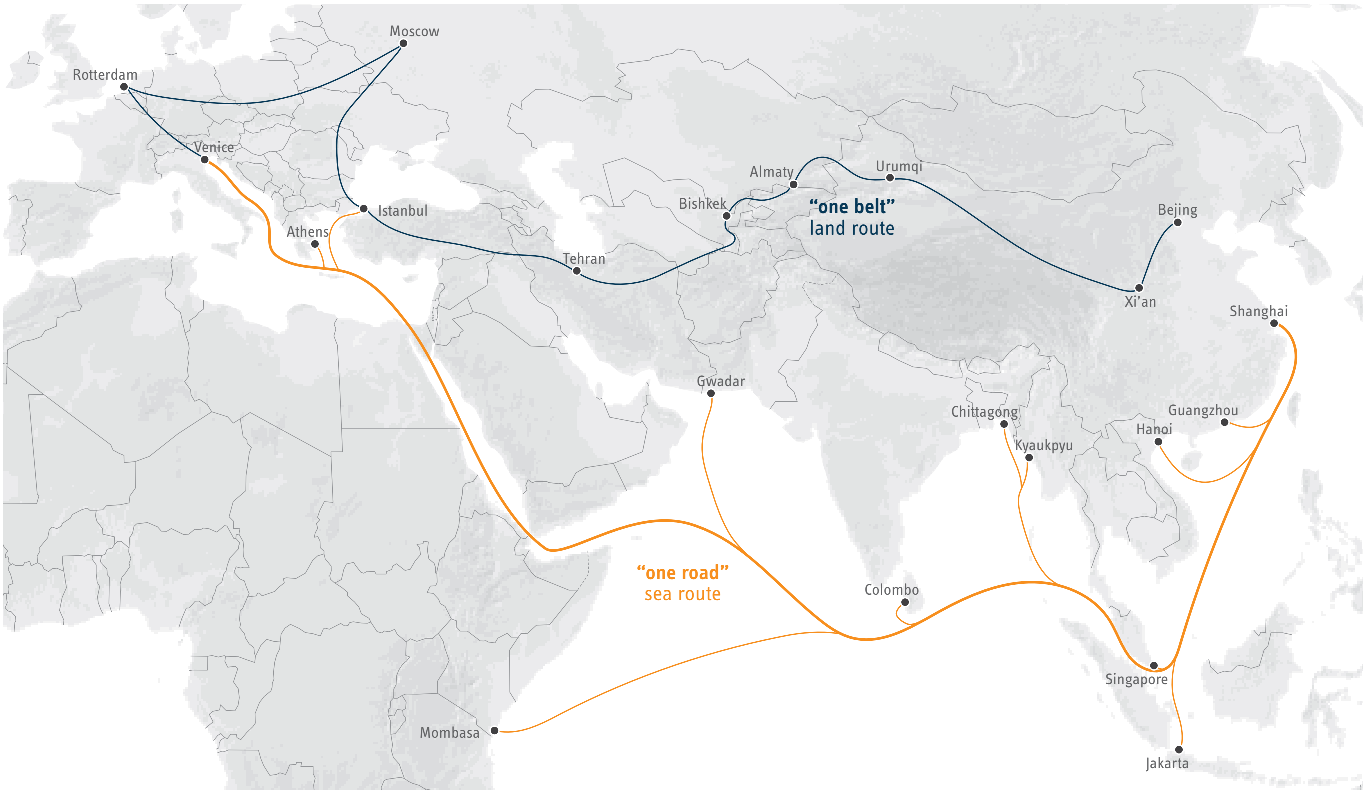
Moreover, in 2013 Beijing raised the status of its relations with Colombo to the level of a strategic partnership, and pledged an additional $2 billion for infrastructure development and expressed a desire to sign a free trade agreement (FTA). Other regional powers, such as India and Japan, followed suit and also made significant investments in Sri Lanka. Meanwhile,

The Belt & Road Initiative (BRI)



Data: The Economist, Natural Earth

between 2005 and 2014 the economy grew mostly thanks to massive public investments in infrastructure, such as roads and motorways, ports and airports; with all of these projects being funded through foreign loans, mostly from China. However, unlike previous concessionary loans provided by the World Bank or the Asian Development Bank, a significant share of the debt to China was commercial loans at a high rate of interest, in the range of 6%. In 2013, foreign debt was growing at a rate of 7.1%, a key indicator pointing to a high risk of debt default. The writing was on the wall, but the Mahinda Rajapaksa administration did not heed the warning signs.

Early elections in January 2015 brought an abrupt end to Rajapaksa's presidency. However, the Maithripala Sirisena administration inherited dangerously high budget deficits and levels of public debt, and immediately faced a balance of payments crisis. In 2016, Sri Lanka's external debt soared to an estimated $25.3 billion, out of which some $8 billion was owed to China. Meanwhile, work on the Colombo Port City was suspended by the Sri Lankan government in early 2015, subject to a supplementary environmental impact assessment (EIA) and a renegotiation of the terms of the deal. A furious Beijing reacted by stating that a failure to continue work on the Colombo Port City project and other China-backed operations could have drastic ramifications on broader Chinese investment and aid flowing into the country. The debt trap left no room for manoeuvre to the Sirisena administration: permission for work to resume was issued in March 2016, upon the completion of the supplementary EIA and the formulation of 40-odd additional conditions set by the government. By January 2018, 60% of the reclamation work had been completed. With regard to the Hambantota project, in April 2017 the Sri Lankan government agreed with Beijing to write-off $1.1 billion of the debt owed to China in exchange for a controlling equity stake in the port.

What do the neighbours say?

China's growing presence in Sri Lanka, at the tip of the subcontinent and India's 'underbelly', has caused undisguised unease in New Delhi, Beijing's most vocal regional competitor. India has persistently protested over what it perceives as a form of strategic encirclement through China's 'String of Pearls' – the network of Chinese projects and investments spanning the Indian Ocean. The Indian government is concerned about whether the sea ports acquired or being expanded by China could perform a strategic (including military) function rather than a purely commercial one, given that most Chinese investments are made by SOEs which are firmly in the hands of the central government in Beijing.

India formally complained after Chinese military vessels made unannounced visits to the Colombo port – one submarine in September 2014, and another submarine and a warship in November 2014. In the latter case, one important detail that did not make it into mainstream reporting was the fact that the submarine Changzheng-2 did *not* dock in a Sri Lanka-controlled port facility designed to accommodate military vessels. Instead, the submarine ended up at the Colombo South Container Terminal, a facility controlled by a Chinese developer. It is unclear whether this happened with the express approval of the Sri Lankan government or not.[4]

Furthermore, Colombo and the Hambantota port could very well boost the Chinese economic presence across the whole of South Asia. India and Sri Lanka have an FTA which allows Sri Lankan goods to enter the vast market of the subcontinent free of duties. Chinese manufacturers could thus use future assembling facilities in Hambantota and the India-Sri Lanka FTA to export low-price consumer goods to South Asia. In addition to the obvious geopolitical implications of Beijing's influence in Sri Lanka, the prospects of China's economic expansion in the wider region are yet another cause for concern for India.

What does it all mean?

The two ports of Colombo and Hambantota exemplify important aspects of China's understanding of connectivity, both in terms of content and modalities. There is a pronounced focus on infrastructure along BRI routes, with a view to supply chains of strategic importance to Beijing. It is becoming increasingly clear that in the Indian Ocean, China is implementing a comprehensive plan that merges energy security, trade, manufacturing and financial services on a regional, if not global, scale. In addition, it appears that the infrastructure built or acquired by China is of potential dual use, with a strong in-built security component, as illustrated by the recorded presence of Chinese military vessels in Sri Lanka (and elsewhere). This is inevitably causing an exacerbation of regional rivalries in what is rapidly turning into a 'Sino-Indian Ocean'.

With regard to modalities, environmental sustainability does not seem to be a top priority for Chinese corporations, and it is only through pressure that they are likely to comply with relevant requirements. However, the most striking feature of the Sri Lanka case is the imposition of China's terms that are hardly in line with the much-trumpeted 'win-win' rhetoric of Beijing.

The debt trap Sri Lanka has found itself in may well provide some useful lessons learned. On the one hand, infrastructure development in the region may come at a cost to national sovereignty and independence. On the other hand, China seems to be replicating in Sri Lanka and across the region what it has always viewed as a major source of humiliation – the 99-year lease of Hong Kong to the UK between 1898 and 1997. Ironically, China's interpretation of 'connectivity' in the Indian Ocean bears some odd similarities with the colonial practices that Beijing has traditionally denounced.

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2) Notably, China became the biggest gross crude oil importer worldwide in 2017 and, in conjunction with declining domestic oil production, this has led to growing refinery capacity and strategic inventory stockpiling. "China surpassed the United States as the world's largest crude oil importer in 2017", 5 February, 2018, *US Energy Information Administration*, https://www.eia.gov/todayinenergy/detail.php?id=34812.

3) The China Harbour Engineering Corporation is a subsidiary of the state-owned China Communications Construction Company (CCCC), which was blacklisted by the World Bank between January 2009 and January 2017 for fraudulent practices related to a construction project in the Philippines.

4) Ankit Panda, "Sri Lanka May Bar Port Visits by Chinese Submarines", *The Diplomat*, 3 May, 2015, https://thediplomat.com/2015/03/sri-lanka-may-bar-port-visits-by-chinese-submarines/.

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