

China's "Belt and Road Initiative" in Sri Lanka : Debt Diplomacy in Hambantota Port Investment

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Abstract

This article will discuss the impact of China's debt diplomacy in Sri Lanka through the Belt Road Initiative (BRI) which has an impact on China's control of the Hambantota Port for 99 years. The Belt and Road Initiative with the promotion of infrastructure investment is an example of the use of Chinese soft power diplomacy on a global level. In the Hambantota Port development project, Sri Lanka relied on development funding from China and subsequently defaulted. At first the Sri Lankan Government under the leadership of Mahinda Rajapaksa opened the investment door for China. From 2010 to 2015, China provided a \$ 4.8 billion loan to build various infrastructure projects including the Hambantota Port, new airports, power plants and highways. Sri Lanka was then caught up in debt diplomacy carried out by China. Then, this article also discusses the response and efforts of the Sri Lankan government to renegotiate the ownership of Chinese shares in the Hambantota Port project. The Sri Lankan government is working hard to get out of the debt diplomacy trap. This article also then discusses the strategic economic and political impacts of controlling the Hambantota Port by China. This article uses books, research reports, theses, journals, newspapers, and online news as reference material.

Keywords : belt road initiative, debt diplomacy, soft power, China, Sri Lanka.

Abstrak

Artikel ini akan membahas dampak diplomasi utang Tiongkok di Sri Lanka melalui Belt Road Initiative (BRI) yang berdampak pada kendali Tiongkok terhadap Pelabuhan Hambantota selama 99 tahun. Inisiatif Sabuk dan Jalan dengan promosi investasi infrastruktur adalah contoh penggunaan diplomasi soft power Tiongkok di tingkat global. Dalam proyek pengembangan Pelabuhan Hambantota, Sri Lanka mengandalkan dana pembangunan dari Tiongkok dan kemudian gagal. Pada awalnya Pemerintah Sri Lanka di bawah kepemimpinan Mahinda Rajapaksa membuka pintu investasi untuk Tiongkok. Dari 2010 hingga 2015, Cina memberikan pinjaman \$ 4,8 miliar untuk membangun berbagai proyek infrastruktur termasuk Pelabuhan Hambantota, bandara baru, pembangkit listrik, dan jalan raya. Sri Lanka kemudian terjebak dalam diplomasi hutang yang dilakukan oleh Tiongkok. Kemudian, artikel ini juga membahas tanggapan dan upaya pemerintah Sri Lanka untuk menegosiasikan kembali kepemilikan saham Tiongkok dalam proyek Pelabuhan Hambantota. Pemerintah Sri Lanka bekerja keras untuk keluar dari perangkap diplomasi utang. Artikel ini juga membahas dampak ekonomi dan politik strategis dari pengendalian Pelabuhan Hambantota oleh Tiongkok. Artikel ini menggunakan buku, laporan penelitian, tesis, jurnal, surat kabar, dan berita online sebagai bahan referensi.

Kata kunci: inisiatif jalan sabuk, diplomasi utang, kekuatan lunak, Tiongkok, Sri Lanka.

Background

Sri Lanka is aware of its geostrategic position and the advantages of its ports in the Indian Ocean region. One of them is Hambantota Harbor which is located along one of the busiest shipping routes in the world. Sri Lanka has the potential to become an advanced commercial center so that it can accelerate the country's economy and trade with the help of infrastructure investments from foreign countries such as China. China has invested \$ 1.5 billion in the Hambantota Port Development Project. This investment is carried out without proper study or consideration of other payment options. The port's economic inability, massive maintenance costs, and large interest payments have caused a serious 'debt trap' for Sri Lanka. In December 2016 an initial agreement between the two parties was signed, in which the Sri Lankan government was expected to sell an 80 percent stake in Hambantota Port for a 99-year lease worth \$ 1.12 billion (Patrick, National Maritime Foundation, 13 April 2017).

Such vulnerability to global influence is one reason China spent millions of dollars in 2015 trying to re-elect Sri Lankan president, Mahinda Rajapaksa, who signed the foreign debt. Mahinda Rajapaksa's regime has built closeness with

China when Sri Lanka faces international isolation at the end of a brutal civil war between the Sri Lankan government and the Tamil Tiger separatist group. China continues to provide funding and support for Rajapaksa, and instead Rajapaksa supports China's foreign policy objectives in the region. During his presidency, Mahinda Rajapaksa opened the door for investors and lenders from China. From 2010 to 2015, when Rajapaksa came to power, China provided a total loan of \$ 4.8 billion to build a number of development projects such as Hambantota Harbor, new airports, coal-fired power plants and highways. In 2016, China increased its loan to \$ 6 billion to Sri Lanka (The Economic Times, 3 September 2018).

Apart from China's financial support in the 2015 elections, Mahinda Rajapaksa lost the election to alleged corruption cases. But the newly elected government has only a few limited choices besides agreeing to Chinese requests to hand over Hambantota Port in 2017 because the country's debt is getting worse. In 2017, \$ 1.12 billion of Sri Lanka's debt was written off from a \$ 1.5 billion loan by China in return for a long-term lease in Hambantota Port (The Economic Times, 3 September 2018).

In pursuing this dream, Sri Lanka relies on development financing from

China. Then Sri Lanka was unable to repay the loan and in 2017, Sri Lanka agreed to give China a controlling equity stake in the port and a 99-year lease right to operate it (Center for Strategic and International Studies, csis.org, 27 November 2018). Sri Lanka officially handed over control of Hambantota Port to China as part of a 99-year lease agreement. Under an agreement of \$ 1.12 billion which was opposed by political opposition groups and trade union alliances. Chinese companies now hold a 70 percent stake in Hambantota Port (The National, 14 December 2018).

Research Question

How does China conduct debt diplomacy through investment in Belt and Road Initiative in Sri Lanka?

Theoretical Framework

1. China's Soft Power and Belt Road Initiative

Joseph S. Nye as mentioned by Mustafa Yagci (2018) in "Rethinking Soft Power in Light of China's Belt and Road Initiative" said that a country's soft power is an indirect way to use power in such a way that you have the ability to make "other people want what you want" and you can set the agenda and define the debate framework by relying on intangible power

resources such as culture, ideology, and institutions. Nye then gave a more detailed explanation of soft power: "Soft power is the ability to influence other parties through co-optation in framing the agenda, persuading, and generating positive attraction to obtain the expected results".

E.H. Carr as mentioned by Mustafa Yagci (2018) in "Rethinking Soft Power in Light of China's Belt and Road Initiative" identified military power, economic power, and power over opinion as the three main forms of power in the international world and stated that although theoretically can be separated, in practice hard power and soft power are interdependent. Then Joseph S. Nye underlined that resource tangibility has a secondary role in the conceptualization of its soft power and emphasizes the definition of soft power behavior. Regardless of whether a country uses tangible or intangible resources, how these resources are used has an important importance in bringing behavioral explanations into soft power.

So, if a country can produce co-optation behavior from other countries through attraction rather than coercion, this is the implication of soft power. Explaining the interdependence between hard power and soft power resources, Gallarotti emphasizes that hard power can increase soft power and vice versa. Thus, it is very

important to have an understanding that there are interdependencies between hard power and soft power resources, which cannot be easily distinguished in different contexts (Yağci, Uluslararası İlişkiler, 2018).

Nye later coined the term "smart power" to explain that a combination of soft power and hard power resources was needed for effective foreign policy. Nye suggested that the United States could be a smart power country by investing in global public goods, whose benefits could be enjoyed by all countries. In other words, the provision of public goods in the international system requires a combination of hard power and soft power resources.

Interestingly, the Belt and Road Initiative (BRI) with the promotion of infrastructure investment and joint development are examples of the supply and distribution of global public goods offered by China to the world. An important aspect of soft power is that countries with soft power capabilities need the ability to set and frame the agenda so that other countries will be interested in providing public goods for their own benefit. In BRI, China handles shortages, vulnerabilities in the global economy, promises solutions and builds consensus among many countries for their participation. This is a clear indication of China's soft power capabilities. In the

case of BRI, the global political economy context formed by unfavorable conditions for economic development in the aftermath of the Global Financial Crisis and the reluctance of the United States to dominate the provision of global public goods has left a power vacuum easily replaced by China (Yağci, Uluslararası İlişkiler, 2018).

Mustafa Yagci (2018) said in 2004, Chinese foreign ministry officials formed a diplomatic strategy to accelerate China's cultural and economic diplomacy to the world and have voiced their concern about an unfair international system to encourage China's economic diplomacy activities abroad. In 2007, Chinese President Hu Jintao underlined the importance of improving soft power culture to make China "more politically influential, more economically competitive, more attractive in its image, and more morally inspiring". Cultural and economic diplomacy activities are the most widely used strategies to promote Chinese soft power. In the context of cultural diplomacy, opening Confucius Institutes around the world is an important aspect in promoting Chinese soft power. On the other hand, China's economic diplomacy is the cornerstone of China's soft power.

Since the start of the global financial crisis in 2008, China has entered its leadership phase for economic

diplomacy. The Chinese President, Xi Jinping, began pursuing active economic diplomacy during the first year of his tenure by popularizing the concept of "Chinese Dream" and the success story of China's economic development supporting China's appeal to African countries and the Asia-Pacific region. Chinese President Xi Jinping maintains economic diplomacy with an emphasis on increasing the sound representation of China and other developing countries by reforming the international system and global governance. From a historical perspective, BRI is the latest and most ambitious manifestation of China's economic diplomacy activities (Yağci, Uluslararası İlişkiler, 2018).

Mustafa Yagci (2018) explains in economic diplomacy activities, the state seeks to achieve a balance between three tensions : 1) tensions between economy and politics; 2) tensions between international and domestic pressure; 3) and tension between the government and other forces. Trying to reconcile these tensions, economic diplomacy can be described as using political tools to advance the prosperity of the national economy and use economic means to achieve domestic political stability.

In its economic diplomacy activities, China has economic and political

goals. For example, one reason behind China's international initiatives was related to domestic economic reform efforts. Third Plenary Session of the 18th Central Committee of the Chinese Communist Party that took place in November 2013 and produced a decision to deepen China's economic reform by exporting excess production capacity to other countries. Then utilizing the accumulation of foreign exchange reserves with more profitable investments, taking more steps for financial liberalization and establishing a mechanism of cooperation with developing countries (Yağci, Uluslararası İlişkiler, 2018).

With this reform effort, China aims to turn its investment-based economy into a consumption-based economy by avoiding the trap of middle income and achieving higher income levels. On the other hand, China is utilizing economic diplomacy in achieving foreign policy goals. China does not shy away from coercive economic diplomacy in pursuing foreign policy objectives and China is alleged to have carried out these coercive activities secretly in order not to damage its international image and reputation. Thus, China does not hesitate to use economic diplomacy in forcing other countries to adhere to certain political and security issues that benefit their interests (Yağci, Uluslararası İlişkiler, 2018).

These projects require an unprecedented level of financial investment. China Development Bank, as one of the main funders of BRI projects, tracks more than 900 projects in 60 countries worth more than \$ 890 billion, Bank of China is expected to lend around \$ 100 billion between 2016 and 2018, and Industrial and Commercial Bank of China (ICBC) examines around 130 projects worth \$ 159 billion. When these figures compared to \$ 103.4 billion, the costs were equivalent to the Marshall Plan covering 16 European countries after World War 2, the level of influence of BRI became clearer. To finance these ambitious projects with projected expenditures ranging from \$ 4 trillion to \$ 8 trillion, China does not only depend on the private and public sectors, but also on multilateral organizations and financial capital from other countries. However, most of the financing is expected to come from China. In other words, China relies on its hard power resources in the effectiveness of its economic diplomacy activities (Yağci, Uluslararası İlişkiler, 2018).

What distinguishes BRI from China's previous economic diplomacy is that now China is far stronger, has accumulated unprecedented foreign exchange reserves and can rely on its economic and financial capacity to support

various BRI-related projects in more than 60 countries. When the United States withdraws from its international obligations and has a more protectionist discourse, China can take advantage of the vacuum of international power and be able to use soft power oriented economic diplomacy far more effectively by relying on its economic and financial capacity. This also underlines the interdependence of hard power and soft power resources: when countries can rely on their hard power resources, they can use their soft power much more effectively. Increasing economic and financial capacity of China gives confidence to the Chinese government to pursue ambitious initiatives such as BRI. This belief allowed President Xi Jinping to include BRI in the Chinese Communist Party's constitution at the 19th congress and BRI was framed as an initiative and foreign policy objective of President Xi Jinping (Yağci, Uluslararası İlişkiler, 2018).

2. Debt Diplomacy

In the United States 2018 National Defense Strategy, as mentioned by Sam Parker and Gabrielle Chefitz (2018) in the "Debtbook Diplomacy" :

China's Strategic Leveraging of New Economic Influence and the Consequences for U.S. Foreign Policy", the United States warns that China is utilizing a "predatory

economy "as a means to achieve regional and global strategic goals. One type of predatory economy is what is referred to as "debt diplomacy," which uses debt to obtain strategic assets or political influence over debtor countries coercively.

Parker and Chefits (2018) explained that debt diplomacy itself is not an economic tool or a strategic end goal. Instead, this is a technique used by China by utilizing debt accumulation to advance existing strategic goals. Three of China's main strategic objectives using this strategy are : 1) Filling in the "String of Pearls" to complete the "Malacca Dilemma" and the power of projects along the important South Asian trade routes; 2) weaken and break the US-led regional coalition that opposes Beijing's claims to the South China Sea; and 3) enable the Army Navy People's (PLAN) to push through the "Second Island Chain" to "Pacific blue waters".

Parker and Chefitz (2018) then explain the three stages of how China conducts debt diplomacy through the Belt and Road Initiative. China has used a consistent method to collect and utilize its debts, making it possible to describe the different stages of debt diplomacy and identify countries that will be affected by the debt diplomacy trap.

First, is the stage of investment. China has expanded its infrastructure

investment under the Belt and Road Initiative (BRI). Work mainly through the Bank of China's China Development Bank and Export-Import (Exim) which collectively has more assets than the combined number of all Western-backed multilateral development banks. China is able to provide longer grace periods and long-term loans from other institutions. This grace period is very attractive for economically weaker countries that are less able to access international financing and corrupt or authoritarian leaders who are seeking political legitimacy and personal financial benefits. These politicians tend to sign vague contract and financing agreements on long-term economic projects because they will leave the government office long before the bill is due.

Second, are the stages of construction and operation. Chinese projects have a reputation for running over budget, with poor construction quality and weak security standards. After completion, many of these projects have produced extraordinary returns, most of which were directed back to China, making debt payments more challenging. In countries such as Sri Lanka and Myanmar, public protests have erupted over projects that prioritize China's interests. The Chinese project failed to create local jobs, deteriorating environmental conditions, exacerbated

corruption and sacrificed state sovereignty. In certain cases, this public pressure has caused the government to freeze or cancel Chinese contracts.

Third, is the stage of debt collection. When countries prove unable to repay their debts, China continues to offer debt forgiveness in return for political influence and strategic equity. As explained by analyst Xiaochen Su "by ensuring that these debts are paid in some form or another, whether it is economic concessions, political agreements, or a combination of both, China may in the long run form new types of diplomatic relations with these countries.

Analysis

Over the years of development and renegotiation with China Harbour Engineering Company, one of China's largest state-owned companies, the Hambantota Port Development Project shows a negative trend and leads to failure. With tens of thousands of ships passing along one of the busiest shipping lanes in the world, Hambantota Port was only able to attract 34 ships in 2012. Then the port was handed over to China. Mahinda Rajapaksa was dismissed from office in 2015, but the new Sri Lankan government struggled to pay for the debts it had. Under heavy pressure and after months of

negotiating with China, the Sri Lankan government handed over Hambantota Port and the surrounding 15,000 hectares of land were valid for 99 years starting in December 2017. The port's surrender gave China control of the area just a few hundred miles from the coast of India, and became a strategic foothold along critical commercial and military waterways (The New York Times, 2018).

The debt agreement also raises some concerns about President Xi Jinping's Belt and Road Initiative which states that global investment and lending programs will impact debt traps for vulnerable countries around the world, encouraging corruption and autocratic behavior in developing countries. Although Chinese officials insist that China's interests in Hambantota Port are purely business, Sri Lankan officials say that from the outset, the intelligence and strategic potential of the port location are part of the negotiations (The New York Times, 2018).

In 2016, China has provided a loan of \$ 6 billion to Sri Lanka to accelerate infrastructure development. But the bulk of the debt that will mature over the next five years precedes the projections of China's loan boom (Nikkei Asian Review, 29 August 2018). In 2017, Sri Lanka borrowed \$ 1.5 billion from the International Monetary Fund, but this loan was also not

enough to cover Sri Lanka's financial problems (The Quartz, 2018).

Meanwhile other analyzes related to the condition of Sri Lanka's foreign debt in 2017 also did not provide a better picture. The debt of the Sri Lankan government is 77.6% of its GDP in 2017, far above the average debt ratio of 69.69% in the period 1950 - 2017 according to the Tradingeconomics report. Meanwhile, the Sri Lankan government budget deficit reaches 5.5% of the country's GDP, adding to the burden on its debt. Strengthening the budget deficit comes at an imprecise moment, Sri Lanka has lived beyond its ability to repay debt, as can be seen from the ongoing balance deficit, reaching 2.6% of the country's GDP in 2017 (The Forbes, 2018).

Then in May 2018, Sri Lanka took a new \$ 1 billion loan from the China Development Bank. Sri Lanka is not the only country that is now worried about debt from China. The Center for Global Development, a non-profit research firm, analyzes the potential debt of countries to China that will be issued when participating in the Belt and Road Initiative investment scheme. It was concluded that eight countries found themselves vulnerable to debt above average, namely: Djibouti, Kyrgyzstan, Laos, Maldives, Mongolia,

Montenegro, Pakistan and Tajikistan (The Quartz, 2018).

Although China has eliminated around \$ 1.12 billion in debt from the Hambantota Port project, Sri Lanka now has more debt to China than before, because other loans from China continue and interest rates remain much higher than other international lenders. Estimates of the Sri Lankan Ministry of Finance describe a gloomy thing. In 2018, the Sri Lankan government is expected to generate \$ 14.8 billion in state revenues, but the debt repayments scheduled to various lenders around the world reach \$ 12.3 billion (The New York Times, 2018).

In 2018, the Sri Lankan Central Bank cooperated with People's Bank of China to issue yuan-denominated bonds worth \$ 250 million. China has become the biggest lender to Sri Lanka but Sri Lanka maintains its tendency to continue lending China, rather than choosing international bonds, even though interest rates are higher (The Economic Times, 3 September 2018). Sri Lanka has also received a syndicated loan of \$ 1 billion from China Development Bank on condition that the Sri Lankan Central Bank says Chinese loans are more profitable than those offered by Western international lenders. After the first \$ 500 million loan package was transferred, Sri Lanka maintained a tendency to choose

Chinese loans rather than international bonds such as the International Monetary Fund (IMF) or other funding options. At the same time, the Sri Lankan government has been reminded that its \$ 8.5 billion in foreign exchange reserves are not sufficient for the debt repayment scheme (Nikkei Asian Review, 2018).

In 2018, the total foreign debt of Sri Lanka is estimated at \$ 55 billion. The lenders include China, Japan, the Asian Development Bank, the World Bank and the International Monetary Fund. So that between 2019 and 2023, Sri Lanka must generate \$ 17 billion to be able to pay off debts and foreign loans that are due. China charged an interest rate of 6.3% for loans to Sri Lanka, while the soft loan interest rates from the World Bank and Asian Development Bank were only 0.25-3%. The interest rate of the Indian Credit Line to neighboring countries is only 1%, or even less in some cases (The Economic Times, 2018).

Sri Lanka, which has an economic power of \$ 87 billion, actually has to wrestle with more debt payments in 2019. Sri Lanka's balance sheet deficit in 2018 of 2.2% of gross domestic product will drive the total debt burden to be paid in 2018 to \$ 7 billion. Sri Lanka will be an outlier in terms of its debt indicators among other countries. Sri Lanka's debt ratio amounts to

77% of its total GDP. This amount is higher than the debt to GDP ratio of other countries such as India, Pakistan, Malaysia and Thailand (Nikkei Asian Review, 2018).

1. The Entry of Chinese Investment in the Sri Lanka Infrastructure Project

It takes about a decade for China to make a breakthrough in Sri Lanka, with a difficult political and economic background in the face of the complicated combination of domestic politics and regional geopolitics. In 2007, China's presence strengthened in Sri Lanka when China provided military and diplomatic support to President Mahinda Rajapaksa to destroy the Tamil Tigers. China quickly positioned itself as Sri Lanka's main ally by providing military assistance and development. China then provided infrastructure projects and high-interest loans that made Sri Lanka indebted and bound to China. In addition, in 2013 Beijing upgraded the status of its relationship with Colombo to a strategic partnership level, and promised an additional \$ 2 billion in infrastructure development. China also expressed a desire to sign a free trade agreement with Sri Lanka (Tonchev, European Union Institute for Security Studies Brief Issues, 2018).

Between 2005 and 2014, Sri Lanka's economy grew largely thanks to massive public investment in infrastructure, such as highways, ports and airports. All of

these projects are funded through foreign loans, mostly from Chinese loans. However, unlike the previous concession loans granted by the World Bank or the Asian Development Bank, a significant part of debt to China is commercial loans with high interest rates in the range of 6%. In 2013, Sri Lanka's foreign debt grew at a rate of 7.1%, becoming the main indicator that shows the risk of high debt default (Tonchev, European Union Institute for Security Studies Brief Issues, 2018).

In 2007, the Sri Lanka Port Authority began designing an economic port development plan. Then this development project opened up limited investment to the business world in 2010. The first major loan taken for this project came from the Chinese state bank, the Export-Import Bank (Exim Bank) of \$ 307 million. But to get a loan, Sri Lanka was asked to accept the company designated by the Chinese government, the China Harbour Engineering Company, as a port maker. These conditions are a typical condition of China for projects around the world, and do not allow the bidding process to open. Across the region, the Chinese government lends billions of dollars and is paid back with a premium to hire Chinese companies and employ thousands of Chinese workers (The New York Times, 2018).

Mahinda Rajapaksa opened the door for Chinese investors and companies. From 2010 to 2015, China provided a \$ 4.8 billion loan to build various infrastructure projects including Hambantota Port, new airports, coal-fired power plants and highways (Nikkei Asian Review, 2018). Determined to continue to expand the port project, Mahinda Rajapaksa returned to borrow \$ 757 million to the Chinese government in 2012. The Chinese government approved Rajapaksa's request but the requirements were far more severe. The first loan of \$ 307 million, initially came at a variable rate of interest rates that were usually set at above 1 or 2 percent after the global financial crisis in 2008. In comparison, Japan's similar loan rates for infrastructure projects were set to be under half a percent. China set its initial loan at a much higher interest rate of 6.3 percent but to get new funding, Rajapaksa approved the proposal (The New York Times, 2018).

During the 2015 Sri Lanka general election, large payments from China's port development funds flowed directly into the campaign activities of candidate President Mahinda Rajapaksa, who had agreed to all Chinese requirements and was seen as a key ally in China's efforts to weaken Indian influence in South Asia. Payments are confirmed by cash documents and checks detailed in the Sri Lankan government

investigation. In the final months of the 2015 Sri Lanka general election, the Chinese Ambassador violated diplomatic norms and influenced elections to support Mahinda Rajapaksa's regime rather than the political opposition (Maithripala Sirisena) by threatening to cancel China's economic agreement with Sri Lanka. When the election time in January drew near, a large flow of funding began to flow into the financial cash of Rajapaksa's campaign team (The New York Times, 2018).

At least about \$ 7.6 million has been sent from China Harbor's account at Standard Chartered Bank to an affiliated bank account to Rajapaksa's campaign team. The report details China's Harbor account numbers, of which 10 days before the election were opened, around \$ 3.7 million were distributed in checks, \$ 678,000 to print campaign shirts and other campaign promotional material, \$ 297,000 to buy supporting souvenirs, including sari cloth for woman. Another \$ 38,000 was paid to popular Buddhist monks who supported Rajapaksa's campaign, while two checks worth \$ 1.7 million were sent by volunteers to Temple Trees, his official residence. Most payments come from account accounts controlled by China Harbour, called "HPDP Phase 2", an abbreviation for the Hambantota Port

Development Project (The New York Times, 2018).

Increasing debt of infrastructure projects, the issue of the flow of Chinese funds to candidate President Rajapaksa caused Sri Lanka's political opposition to get a strong political issue and they campaigned with suspicion about China's intervention in the 2015 elections. These political issues caused Mahinda Rajapaksa to lose in the 2015 general election.

2. Problems in the Hambantota Port Development Project

The Hambantota Port construction project did not appear in a short time, but it resulted from a series of decisions by the Sri Lankan government. Many other infrastructure projects funded by China were not requested to return, but Hambantota Port was not included in the project. The construction of Hambantota Port has been the official development plan of the Sri Lankan government since 2002. In 2003, SNC Lavalin, a French construction company, completed a feasibility study for the port. A task unit appointed by the Sri Lankan government reviewed and rejected the results of the study. The unit criticized a feasibility study that ignored the potential impact of Colombo Port, which in recent years has handled 95 percent of Sri Lanka's

international trade (Center for Strategic and International Studies, 2018).

The Hambantota Port construction project is an initiative of the Sri Lankan government to further develop a strategic port and plan an industrial zone of 1,235 hectares. The port project was financed and built by China Merchants Port Holdings Company, a company wholly owned by the Chinese government. China Merchants Port Holdings has a subsidiary, Colombo International Container Terminal Limited, which in addition to developing Hambantota Port, also operates the South Colombo Terminal through a 35-year Build-Operate-Transfer agreement (Patrick, National Maritime Foundation, 2017).

Anjelina Patrick (2017) Indian National Maritime Foundation researcher in "China - Sri Lanka Strategic Hambantota Port Deal" said that between 2005 and 2006, Ramboll, a Danish consulting company conducted a feasibility study on the construction of Hambantota Port. The development project is divided into three phases. The first phase of the development project has been completed and is now entering an operational period. The construction of the first phase is estimated to cost \$ 360 million, with 85 percent of the funding coming from China Exim Bank and the remaining 15 percent funding financed

by Sri Lankan Port Authority. In addition to loans, Sri Lanka must incur additional costs such as payments to Danish consulting companies, land costs obtained for construction and payment of fluctuating equipment costs.

Construction work for the second phase of the project has been substantially completed. The second phase is estimated to cost around \$ 750 million. The development project also includes an artificial island, which was built with excavated material obtained from the construction of Hambantota Port. The island is located within the boundary of the port development area and has an area of around 43 hectares. The third phase of the development project is expected to be completed by 2023, but this development project appears null and void (Patrick, National Maritime Foundation, 2017).

In 2006, Ramboll then completed a second feasibility study. The study produced an optimistic view of the potential of ports based on traffic projections on Sri Lanka's future growth from ports in Colombo, Galle and Trincomalee. Receiving and dismantling bulk cargo (commodities and goods loaded separately rather than standard containers) will provide the main source of shipping traffic until 2030, when the balance will begin to shift towards container traffic. In 2040,

Hambantota Port is projected to handle 20 million containers of twenty feet (TEU) containers, comparable to the fifth busiest port in the world in 2015 (Center for Strategic and International Studies, 2018).

With this assessment, President Mahinda Rajapaksa gained legitimacy to realize the project's development. Chosen in the 2005 elections, Rajapaksa has promised to develop the southern district of Sri Lanka, especially his native Hambantota region, which is one of the areas devastated by the 2004 tsunami disaster. During Rajapaksa's reign, Sri Lanka began a series of ambitious infrastructure projects. Many of these large-scale infrastructure projects including international airports, cricket stadiums and ports have three things in common: they use Chinese financing, Chinese contracting companies and guarantee the name Mahinda Rajapaksa (Center for Strategic and International Studies, 2018).

Hambantota Port has a value of \$ 1 billion, such a value is not only business dimension but also political. Hambantota's development vision is to bring more ships to Sri Lanka and reduce the volume density of ships in Colombo Port. Sri Lanka is located on the sea lane crossed by oil shipping trips from the Middle East, making the issue of energy security the main reason China wants to invest in Sri

Lanka (BBC News, 2017). Emphasizing the political approach rather than market demands, this approach failed to place Hambantota Port in a larger development strategy. Colombo Port handles 5.7 million TEUs in 2016 and will continue to grow in the coming years. If Port Colombo's plan is realized, its capacity will increase to 35 million TEUs in 2040. The initial plan of Hambantota Port focused on fuel services, but under Rajapaksa the plan was increased to include other activities, most of which had been carried out at Colombo Harbor. The problem of developing Hambantota actually came from Sri Lanka's own domestic (Center for Strategic and International Studies, 2018).

In 2012, Hambantota Harbor struggled to attract more ships to come, where container ships preferred to dock at Colombo Harbor. To increase the number of ships coming to Hambantota Port, the Sri Lankan government then issued a decision in 2012, that ships carrying imported cars to the port of Colombo would drop their cargo at Hambantota to start businesses there. However, only about 34 ships docked in Hambantota in 2012, compared with 3,667 ships in Colombo Port, according to the annual report of the Sri Lanka Ministry of Finance (The New York Times, 2018).

Hambantota Port has been optimized by the Sri Lankan government to

be able to generate profits, but the port is difficult to develop because its territory is still isolated. Without a hub-industrial area in the vicinity, there is nothing that can become a natural customer for the port. But now China seems to be taking over the port. China wants to fix the isolated region's problem and talk with the Sri Lankan government about plans to build a large economic zone. China plans to buy 15,000 hectares of land and build factories and offices around the Hambantota Port complex. The amount of Sri Lanka's debt in the construction of Hambantota reached \$ 64 billion, around 95 percent of all Sri Lanka's income is used for debt repayment (BBC News, 2017).

Sri Lanka was then caught up in debt diplomacy carried out by China and is now struggling to repay the loan money. The Sri Lankan government finally signed an agreement to give Chinese companies share ownership in the port as a way to pay for part of the debt. Interest rates on Chinese loans are often very high. The first phase of the Hambantota Port project is a loan of \$ 307 million with an interest of 6.3 percent. Multilateral development banks usually offer loans with interest rates between 2 or 3 percent, and sometimes close to 0 percent. The reason why China managed to lock Sri Lanka at this high interest rate is because there are often no

other loan alternatives available. Another reason is that Chinese loans are not so strict in their requirements for project safeguards. The absence of other competitive offers for Hambantota Harbor shows that other potential lenders do not see potential benefits commensurate with project risk (Center for Strategic and International Studies, 2018).

The Hambantota Port project has suffered heavy losses due to ongoing maintenance costs, debt repayments, and interest payments. Sri Lanka's total debt is approximately \$ 64.9 billion, of which \$ 8 billion is owed to China. For the Hambantota Port project alone, Sri Lanka has borrowed \$ 307 million from China at an interest rate of 6.3 percent. This large debt is generated from the decision of the Rajapaksa government, which has obtained loans for large-scale infrastructure development projects from China without adequate assessment of its implications (Patrick, National Maritime Foundation, 2017).

Then in 2015, the Siresena government inherited this debt. Unable to generate revenue from a failed project and with a large loan to repay, Sri Lanka has fallen into a debt trap, causing Sirisena's government to enter into an agreement with China Merchants Port Holdings Company. The Sirisena government believes that the

only feasible agreement is to convert the loan into equity to alleviate some of the debt to China (Patrick, National Maritime Foundation, 2017).

3. Failure to Pay-Debt and Hand Over of Hambantota Port

After the defeat of Mahinda Rajapaksa in the 2015 election, the new government led by President Maithripala Sirisena held the power with a mandate to carry out a scrutinization of Sri Lanka's financial transactions and stop the construction process in Hambantota Port. Sri Lanka faces a terrifying amount of debt under Rajapaksa's government, the country's debt has tripled to \$ 44.8 billion when he left power. In 2015, payments of \$ 4.68 billion were due at the end of the year. In 2016, Sri Lankan government officials began meeting with the Chinese government to reach an agreement. Sri Lanka hopes that port debt can be removed from the Sri Lanka balance sheet and avoid outright defaults. But the Chinese government demands that Chinese companies can take the dominant share of equity in the port in return. When Sri Lanka is given the choice of where Chinese state companies will take control of the port: China Harbour or China Merchants Port Holdings according to the final agreement

between the two countries (The New York Times, 2018).

China Merchants Port Holdings obtained the contract and urged more. Company officials demanded 15,000 hectares of land around the port to be built for an industrial zone. Chinese companies argue that the port itself is not worth \$ 1.1 billion to be paid for its equity, money that will cover Sri Lanka's debt at the port project. The Sri Lankan government has fiercely opposed the terms put forward by China, but there is no way out. The new agreement was signed in July 2017, and came into force in December 2017. The agreement left some signs of Sri Lanka's ownership of the existence of a joint company to manage port operations and collect revenues. The share ownership in the company is 85 percent owned by China Merchants Port Holdings and the remaining 15 percent is controlled by the Sri Lankan government (The New York Times, 2018).

Sri Lanka's small shares will not mean much in the future, given the large influence that China Merchants Port Holdings has on board personnel and operational decisions. When the agreement was initially negotiated, there was a gap that was left open where the surrounding ports and land could be used by the Chinese military, where Indian officials asked the Sri Lankan government to explicitly

prohibit this. The final agreement prohibits foreign countries from using ports for military purposes unless given permission by the government in Colombo. The clause was included in the agreement because the Chinese Navy submarine was on its way to Sri Lanka (The New York Times, 2018).

Sirisena's new government promises to reduce Sri Lanka's dependence on China, but financial pressure has forced it to maintain relations with China. Initially the new government suspended a large infrastructure project invested by China, namely the construction of a new city built off the coast of Colombo above the reclamation area. But the \$ 1.4 billion debt that it brings has proved difficult to reject and rebuilding continued in 2016. The hope is to turn the region into a modern city by 2040, with corporate buildings, apartment blocks, hotels, resorts, beaches, malls and even the marina. China Harbor Engineering Company (CHEC), which is working on the construction project, will acquire around two-thirds of the land marketed with a 99-year lease in return for its investment (BBC News, 2017).

In October 2016, Sri Lankan Prime Minister Ranil Wickremesinghe announced that China Merchants Port Holdings would hold an 80% stake in Hambantota Port in exchange for more than \$ 1 billion in state debt. This share shift will have an impact on

neighboring countries such as India, because China has used Colombo South Container Terminal, which is also owned by the same Chinese company, to close submarines to the pier. This is contrary to the Sri Lanka Port Authority's mooring design intended for military ships. Previously Sri Lanka intended to hide the visit of two Chinese naval vessels from media coverage. With a majority share of Hambantota Port being sold to China's semi-private sector, India must be prepared to accept the possibility of another visit by the People's Liberation Army Navy (PLAN) for a longer period of time (Gunasekara, Asia Pacific Bulletin, 372, 2017).

In December 2016, the Sri Lanka Port Authority and China Merchants Port Holdings signed their first agreement. The agreement states that the Sri Lankan government will sell 80 percent of the \$ 1.12 billion Hambantota Port for a 99-year lease, to Chinese companies. About 20 percent of the remaining shares are owned by the Sri Lanka Port Authority. Total leased land includes all port infrastructure, industrial zones, artificial islands, naval areas, all of which are built on port properties. According to Sri Lanka's Minister of Finance, Ravi Karunanayake, Sri Lanka's debt problems can only be resolved by first completing high-interest

loans through the sale of Hambantota Port (Patrick, National Maritime Foundation, 2017).

On March 21, 2017, the agreement witnessed unexpected changes in its content due to widespread protests and demonstrations by the Sri Lankan people, in connection with the sale of 80 percent of the proposed ports and industrial zones. The Sri Lankan cabinet agreed and proposed a renegotiation of the agreement aimed at reducing current Chinese share ownership in the Hambantota Port project. The proposed revised agreement states that Chinese companies must agree to divest a maximum of 20 percent of initial share ownership by 80 percent in the next decade to Sri Lankan companies. (Patrick, National Maritime Foundation, 2017)

Due to the strong debt pressure, the Sri Lankan government finally failed to divest a maximum of 20 percent of China's share ownership of the Hambantota Port. Sri Lanka then gave majority control over Hambantota Port to China in an effort to repay debts borrowed from China. In 2017, China Merchants Port Holdings paid \$ 584 million as part of a \$ 1.12 billion agreement to operate Hambantota Port. Based on the agreement signed in July 2017, China Merchants Port Holdings will operate the \$ 1.5 billion Hambantota Port for a period of 99 years. The amount of \$ 1.12 billion will

be used to reduce the amount of Sri Lankan government debt to China (The Forbes, 20 September 2018). In December 2017, Sri Lanka officially handed over control of Hambantota Port to China as part of a 99-year lease agreement. Under an agreement of \$ 1.12 billion which was opposed by political opposition and trade unions (The National, 2018).

Chinese companies now hold a 70 percent stake in Hambantota Port. The Sri Lankan government has struggled to pay off debt, because the project caused enormous debt. Along with loans taken for other infrastructure development projects, Colombo now owes a total of \$ 8 billion. Chinese companies under China Merchants Port Holdings now hold a majority stake in the port as part of a joint venture with the Port Authority of Sri Lanka. The lease agreement signed in July 2017 also includes extensive tax concessions for ports and 32-year tax breaks for Chinese companies. For the tax portion, China has paid Sri Lanka a total of \$ 300 million by paying further taxes at an unclear time (The National, 2018).

For Beijing, the take over of Hambantota Port is a long-term part of the Belt and Road Initiative (BRI) project. Other BRI projects include a \$ 10.7 billion plan to develop the city of Duqm (Oman) into an industrial city that will turn the

small port into a major transit center. Closer to Hambantota is the Gwadar Port (Pakistan) developed by Beijing as an important part of the \$ 55 billion China-Pakistan Economic Corridor (CPEC). In addition to Sri Lanka, China has also added the Maldives in the Indian Ocean into the scope of its economic influence through a free trade agreement at the end of November 2017 (The National, 2018).

4. Strategic Implication of China Ownership on Hambantota Port

The case of handing over Hambantota Port is an important part of a network of important access points in the Indian Ocean that was acquired by China, which helped China to weaken the Malacca Strait which was identified as a strategic meeting point by former President Hu Jintao in 2003. Besides China's dependence on sea trade routes access to the Indian Ocean without having to go through the Malacca Strait connects the Western provinces of China to supply route networks for important strategic commodities and reduce thousands of miles of travel in the sea. This is the main reason for the continued presence of China on the edge of the Indian Ocean including Sri Lanka, as part of the Belt and Road Initiative (Tonchev, European Union

Institute for Security Studies Brief Issues, 2018).

Furthermore, the control of Hambantota Port can increase China's economic presence throughout the South Asian region. India and Sri Lanka already have FTAs that allow Sri Lankan goods to enter Indian wide markets without import duties. Thus, Chinese manufacturers can use future assembly facilities in Hambantota Port and India-Sri Lanka FTA to export low-priced consumer goods to the South Asian region. In addition to the obvious geopolitical implications of Beijing's influence in Sri Lanka, the prospect of China's economic expansion in the wider region is another reason to pay attention to India (Tonchev, European Union Institute for Security Studies Brief Issues, 2018).

Hambantota Port exemplifies important aspects of China's understanding of connectivity, both in terms of content and modality. There is a clear focus on infrastructure along the Belt and Road Initiative route, with a view to supplying important strategic chains to Beijing. It is increasingly clear that in the Indian Ocean, China is implementing a comprehensive plan that combines energy security, trade, manufacturing and financial services on a regional and global scale. In addition, it appears that the infrastructure built or

acquired by China has the potential to be used for multiple purposes, with a strong installed security component as illustrated by the presence of Chinese military vessels in Sri Lanka. This inevitably led to the deterioration of regional competition in what later became the 'Sino-Indian Ocean' (Tonchev, European Union Institute for Security Studies Brief Issues, 2018).

Controlling Hambantota Port is part of China's geopolitical goals which will see Beijing challenge the United States as the world's main maritime power. There are fears that China might use ports such as Hambantota, Duqm and Gwadar as naval bases. But Chinese, Indian competitors have their own plans. In response to China's presence in Sri Lanka and along the Indian Ocean, India is planning to purchase 40 years of lease rights from unused airports along the \$ 300 million Hambantota Port. Key elements in overseas naval bases and even logistics facilities are air access for people's distribution and logistics. India will spend \$ 300 million to buy airports in order to ward off and block Chinese naval bases. So far China has only one overseas naval base located in the port of Doraleh in Djibouti. This base has been officially operating since August 2017 (The National, 2018).

In May 2017, Sri Lanka refused a request from Beijing to close submarines in

Hambantota Port. When the Sirisena government took power, it sought guarantees that the Hambantota Port would never again welcome Chinese submarines. This is of particular concern because Chinese submarines are difficult to detect and are often used for intelligence gathering. But the Sri Lankan government simply does not have strong control. After the handing over of Hambantota Port to China raises concerns about the possibility of military use, because China continues to militarize ownership of the island around the South China Sea. The Sri Lankan government shows that the agreement explicitly ruled out China's military use of the port. But the Sri Lankan government that still owes China can be pressured to allow a Chinese military presence at the port (The New York Times, 2018).

The last political development in Sri Lanka showed a shock where Mahinda Rajapaksa returned to power by serving as Prime Minister of Sri Lanka. President Maithripala Sirisena on Friday (10/26/2018) sacked Prime Minister Ranil Wickremesinghe and took the oath of Mahinda Rajapaksa as prime minister. Rajapaksa's return to power triggered public protests and had consequences for the future of democracy, the credit level and the Sri Lankan financial market. Rajapaksa's proximity to Beijing could also

make Colombo more vulnerable to China's influence which continued to strengthen (CNBC News, 2018), President Sirisena suspended parliament, causing Sri Lanka to fall into a constitutional crisis. Sudden political reorganization will strengthen Rajapaksa, whose new party won success in local elections in February 2018 and disrupted political stability. Rajapaksa's rise was the second opportunity for China to play a dominant role in Sri Lanka's politics and development. With Rajapaksa, China will further strengthen its influence and presence in Sri Lanka and the Indian Ocean region (Foreign Policy, 2018).

Conclusion

China through its Belt Road Initiative and infrastructure investment in Sri Lanka has effectively demonstrated the use of soft power and hard power in achieving its foreign policy goals. China combines the means of economic diplomacy and its economic power to carry out an ambitious global connectivity project through the Belt and Road Initiative. China intelligently took the momentum to fill the gap in the position of the main distributor of global public goods after the United States resigned after the Global Financial Crisis. In the context of geopolitical strategies in the Indian Ocean and South Asia, China sees the strategic position of Sri Lanka, an

island nation in southeast India. If China can take control of the sea trade route through the control of ports in Sri Lanka, then China can secure important trade routes in South Asia and weaken the strategic role of the Malacca Strait in the world sea trade route.

In addition, China also carried out three stages in debt diplomacy with Sri Lanka and succeeded in taking over Hambantota Port with a 99-year lease contract. The three stages are: 1) Stages of investment, 2) Stages of construction and operation, and 3) Stages of debt collection and expropriation. In the case study of Hambantota Port, China managed to trap Sri Lanka with loans that had high interest rates and conditions that benefited China such as the appointment of Chinese companies in port development projects. The strength of China's influence on development projects is reinforced by political intervention such as full support for the regime of Mahinda Rajapaksa who is close to China. High-interest foreign debt bondage in large-scale infrastructure projects made Sri Lanka trapped in China's debt diplomacy and forced Sri Lanka to approve a \$ 1.12 billion debt relief agreement in exchange for handing over the 99-year lease of Hambantota Port.

Take over and control Hambantota Port has a strategic implication on China in

the geopolitical context of the Indian Ocean and South Asia. China can cut access to goods from the Indian Ocean without having to go through the Malacca Strait. China can also make Sri Lanka the entry point for Chinese-produced goods to India and South Asia, moreover Sri Lanka and India have an agreement on a free trade agreement (FTA) that facilitates entry of goods without charge. On the security aspect, Hambantota Port can be used as a Chinese naval base other than Duqm Port (Oman) and Gwadar Port (Pakistan). The controlling of Hambantota Port can increase the presence of the People's Liberation Army Navy (PLAN) along the Indian Ocean and open access to sea trade which is more open to the South Asian region, West Asia, the Middle East and the Continent of Africa.

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