

China's Belt and Road Initiative (BRI) and Sri Lanka

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I. INTRODUCTION

Links between Sri Lanka and China, economic relations in particular have grown exponentially during the last decade. So much so that China has become a significant economic partner of Sri Lanka. The Belt and Road Initiative (BRI) is closely connected with this. China has invested large sums of money to develop infrastructure (mega projects) and trade routes for what it believes is a mutually beneficial programme. However, BRI presents both opportunities and challenges for Sri Lanka. On one hand, Sri Lanka gains key infrastructure, capital and skills that could put it well ahead in connectivity and trade facilitation. Combined with these are the added benefits of trade and investment promotion, development of an economic hub, participation in global value chains, employment generation, technology and knowledge transfer that will help with economic growth in the foreseeable future. On the other hand, there is concern around the environmental impact of such infrastructure development, and the geopolitical and sovereignty issues that come with partnering with China and taking on significant amounts of debt.

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This chapter aims to investigate the economic relationship between China and Sri Lanka. In particular, it aims to examine the impact of BRI on the Sri Lanka economy. The chapter is organised as follows: it will provide a historical overview of BRI as well as the relationship between China and Sri Lanka; it will then examine some of the projects/activities linked to BRI in Sri Lanka, their implications for Sri Lanka, highlighting the benefits and concerns.

II. BACKGROUND TO BRI

The US\$4 trillion Belt and Road Initiative (BRI) is considered to be China's most ambitious foreign trade and investment project to date. The project was initially named One Belt One Road (OBOR) and then later renamed as BRI as the term "one" in OBOR implies only a single network while BRI would better reflect the project's numerous network clusters. In October 2017, BRI was written into the Communist Party's constitution at the 19th National Congress of the Communist Party of China (CPC), a sign of the project's policy significance for China and its current leadership.

BRI is China's attempt at rebuilding the network of the Ancient Silk Route, which was a trade route connecting China to Europe through both land and sea routes. Xi Jinping, President of the People's Republic of China, unveiled the project in late 2013 during a visit to Central and South East Asia. BRI focuses on improving connectivity and cooperation among Asian countries, Africa, China and Europe. The emphasis is on enhancing land as well as maritime routes through a network of roads, rail lines and sea ports. This is mainly done through large scale infrastructure projects to improve ports and trade transport. The project spans 65 countries and about 60 percent of the world's population (Djankov, Sand Miner, 2016). The funding for the project comes through Asian Infrastructure Investment Bank (AIIB) and the Silk Road Fund, which is a US\$40 billion development fund created for the initiative.

One arm of BRI, 'Silk Road Economic Belt' (the Belt) extends overland from China to Europe through Central Asia and the other, '21st Century Maritime Silk Road' (the Road), links China to Southeast Asia, the Middle East, east Africa and Europe along the Mediterranean, the Indian, Atlantic and Pacific Oceans connecting over 20 countries (Igbino, 2017). Sri Lanka has been an important stop on the Maritime Silk Road since ancient times. It lies along one of the world's busiest trade routes, connecting Asia with Europe, and plays a key part in China's BRI. The 'Belt' is a series of overland corridors connecting China with Europe, via Central Asia and the Middle East.

The initiative was motivated by the concern of the slowdown of the Chinese economy as it transitioned from an investment led growth model a consumer

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demand growth model. With China experiencing overcapacity in sectors across the country, seeking market access abroad was seen to address this problem at home. Also the initiative will allow Chinese enterprises to access opportunities to undertake various projects and commerce in the BRI countries, assisting them to be globally competitive and become global brands through joint ventures, technology transfers and public-private partnerships. The BRI is considered to be an open and inclusive initiative allowing every country to take part in its development.

Figure 1
Regions covered by BRI



Source: Lowy Institute.

BRI has five key objectives, namely, policy coordination, connectivity, unimpeded trade, financial integration, and people-to-people bonds.. BRI expects to achieve policy coordination through intergovernmental cooperation on macro-economic policies and increased connectivity by developing trade infrastructure

as well as through trade and investment cooperation. Financial integration will be achieved through joint efforts to establish the AIIB and BRICS New Development Bank, signing of MOUs on cooperation in bilateral financial regulation, establishing an efficient regulation coordination mechanism in the region. The objective of developing people to people bonds is expected to be achieved through cultural and academic exchanges and tourism among others.

Southeast Asia and South Asia are expected to be key beneficiaries of BRI (Deloitte, 2018). For the former, that is partly due to proximity to China and a higher state of development, and partly due to the demand for better infrastructure. For the latter, the size of population and vast market potential is noteworthy. Amongst the other beneficiaries include Europe, Russia and Central Asia and Africa. So far, infrastructure has attracted more funding than other sectors although it also encompasses investments in manufacturing and trade, as well as softer investments in tourism and culture.

One of the primary challenges the initiative has faced has been in obtaining the support and cooperation of other emerging economies mainly India. Western powers also remain sceptical of the initiative and view it as a means of China increasing its geopolitical power and influence. Despite this, it has received a high level of cooperation from many nations including those in South Asia (Bangladesh, the Maldives, Nepal, Pakistan and Sri Lanka) and South East Asia.

The BRI project in the past 4 years since its launch has grown in size in terms of investment and the countries being involved. In May 2017, the Belt and Road Forum for International Co-operation was held in Beijing. It was attended by heads of states of 29 governments, representatives from 130 countries and representatives of more than 70 international organizations. This event was the highest-level meeting of its kind since the BRI was proposed in 2013.

The BRI initiative has also extended to Americas (North and South); Chinese investments in Latin America continued to rise in 2017. In little over a decade, China has jumped from being one of Latin America's smallest trading and investment partners to being one of its largest.

III. SRI LANKA'S HISTORICAL RELATIONSHIP WITH CHINA

Sri Lanka-China relationship is centuries old, and has been historically strengthened by shared religious and cultural values in addition to trade and commerce. For many centuries, Sri Lanka had been at the centre of the historical Silk Road connecting Europe and China. Although the initial Silk routes were over land, following the fall of the Mongol Empire in the 14th century, China shifted its approach to include a stronger emphasis on maritime trade (Seneviratne, 2016); Sri Lanka has been part of the maritime trade route of China since then. It has been noted

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that Sri Lanka was an emporium where traders from West and East exchanged wares and the discovery of many Roman coins in some parts of the country bear testimony to it.

The Rubber /Rice Pact between Sri Lanka and China was signed in December 1952, marking a significant milestone in the bilateral ties between the two nations. This was also one of the first agreements that China has signed with a non-communist country (Kelegama, 2014). In fact, it was signed five years before the two countries established formal diplomatic relations (Li, Li, 2017). Through this Pact Sri Lanka guaranteed to import 270,000 metric tons of rice each year while China agreed to purchase 50,000 tons of rubber each year for a period of five years. This Pact was renewed every five years until the year 1982. It is considered to be the most useful trade agreement that Sri Lanka has negotiated in the past, as it ensured that China offered 40 percent more than the market price for rubber while Sri Lanka provided rice for less than a third of its market value. It is also considered to be one of the most successful and durable South-South trade agreements in the world (Kelegama, 2014). Moreover, this Pact paved the way for increased formal diplomatic relations between the countries during the post-colonial rule. The pact was signed despite the protests made by the USA which threatened to invoke the Battle Act and withdraw aid from Sri Lanka. The US Vice President Richard Nixon visited Sri Lanka in November 1953 to dissuade the country from continuing to trade with China, arguing that Sri Lanka was selling strategic material to a Communist country during the height of Korean War. Nixon spent three days in Colombo and after discussions with Sri Lankan authorities, he was convinced that the pact was signed mainly for economic reasons and Sri Lanka did not have sympathies with Communism (Watson, 2010).

In February 1957, formal diplomatic relations were established with China and thereafter in 1962 the two nations signed the first agreement on Economic and Technological Cooperation. The following year a maritime agreement guaranteed that all commercial vessels engaged in cargo and passenger services between the two countries and a third country will be treated on the Most Favoured Nation (MFN) status.

Another milestone in the Sri Lanka-China relationship was the state visit of the then Prime Minister Sirimavo Bandaranaike in 1972. This resulted in the gradual increase in Chinese bilateral aid packages along with the initiation of the construction of the Bandaranaike Memorial International Conference Hall (BMICH). Since then there have been numerous high level visits to China from Sri Lanka. The Chinese side reciprocated and some notable visits include Premier Chou En Lai visit in 1957 and 1964, and more recently the first ever visit by a Chinese President Xi Jinping to Sri Lanka in 2015. These visits further nurtured decades long friendship and cooperation.

In the meanwhile, the Sri Lanka-China Society was formed in 1981 with an aim to strengthen friendship (Jayasekara and Tennakoon, 2007). Additionally, the Sino-Lanka Joint Trade Committee and the Sino-Lanka Economic and Trade Cooperation Committee were signed in 1982 and 1984, respectively. They were then amalgamated in 1991 to form the Sino-Lanka Joint Commission for Economic and Trade Cooperation (MOFA, 1998). In addition, the Sri Lanka-China Business Cooperation Council was formed in 1994 adding to the growing attempts at strengthening the economic relationship between the nations.

The Sri Lanka- China relationship reached another significant milestone under the post-2005 administration. Relations between both countries during the rule of Sri Lankan President, Mahinda Rajapaksa, resulted in many agreements and saw closer relations due to Rajapaksa's pro-China stance. For example, in his state visit to China in 2007, on occasion of the Golden jubilee celebrations of diplomatic relations, President Rajapaksa signed eight bilateral agreements and MOUs with China. They included agreements on economic and technical cooperation, establishment of Friendship City Relationship between Guangzhou and Hambantota, investment promotion cooperation, cooperation in the film industry, academic exchanges, etc. Sri Lanka became one of the first countries to openly support the BRI since it was aligned to the country national development strategy.

Under current Sri Lankan President, Maithripala Sirisena, relations remain strong with the current administration interested in balancing both Chinese and Indian interests in the country. However, recent developments have shown a "pro-China" stance to Sri Lanka's current foreign policy, as demonstrated by the continued Chinese investments in Sri Lanka and the country's support of China's position in the South China Sea dispute. Moreover, President Sirisena and Prime Minister Wickramasinghe and others have expressed their willingness to participate in the BRI and leverage Sri Lanka's geographical position to become an economic hub in the Indian Ocean

IV. ECONOMIC COOPERATION BETWEEN SRI LANKA AND CHINA

TRADE RELATIONS

In the year 2016, China surpassed India to become the largest source of imports to Sri Lanka; in that year, Sri Lanka imported goods valued at USD 4,270 mn., accounting for 22 percent of Sri Lanka's total imports (Table 1). Items classified under electrical machinery, and mechanical machinery are the main imports from China to Sri Lanka while it is also a large provider of iron, steel, cotton and mineral fuels (Figure 3).¹ The amount of trade between the two countries, particularly

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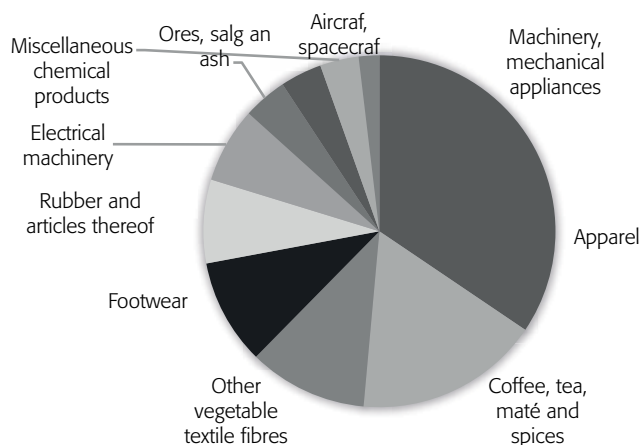
imports by Sri Lanka have grown significantly over the last few years, as shown in Figure 4 below.

Table 1
Sri Lanka's Top 10 Export and Import Markets, 2016 (thousand)

	<i>Exports</i>		<i>% of Exports</i>	<i>Imports</i>		<i>% of Imports</i>
	<i>World</i>	<i>10545893</i>	<i>100</i>	<i>World</i>	<i>19,500,757</i>	<i>100</i>
1	USA	2810220	26.6	China	4,270,756	21.9
2	UK	1045080	9.9	India	3,824,968	19.6
3	India	753481	7.1	UAE	1,067,273	5.5
4	Germany	509881	4.8	Singapore	1,030,316	5.3
5	Italy	428902	4.1	Japan	949,829	4.9
6	Belgium	338187	3.2	Malaysia	642,030	3.3
7	UAE	292867	2.8	USA	539,987	2.8
8	China	215493	2	Thailand	514,463	2.6
9	Netherlands	208334	2	Taiwan	495,929	2.5
10	Japan	203819	1.9	Hong Kong	465,914	2.4

Source: TradeMap Database.

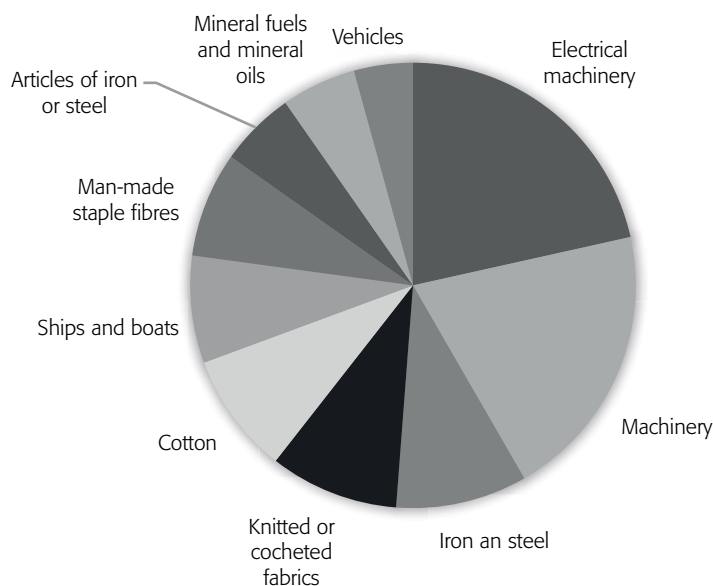
Figure 2
Composition of Sri Lanka's Exports to China 2016



Source: TradeMap Database.

¹ ITC Trade Map (2017).

Figure 3
Composition of Sri Lanka's Imports from China 2016



Source: TradeMap Database.

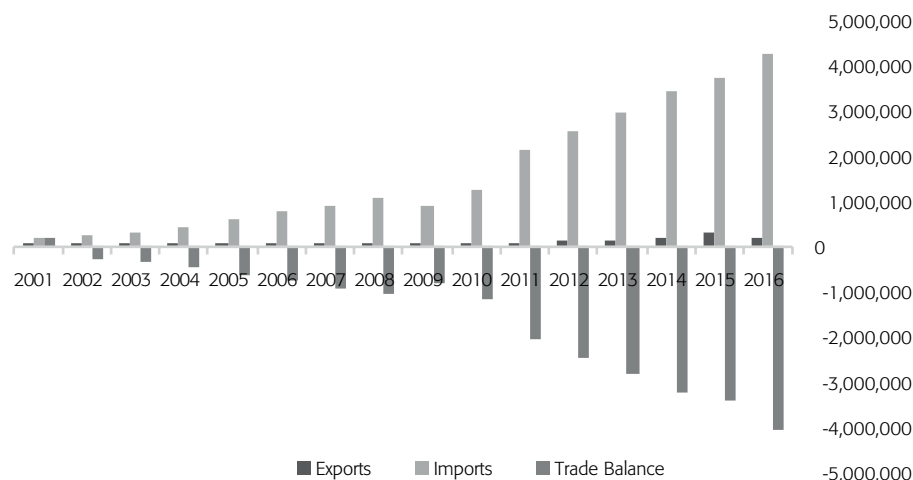
As an exporting market, China is largely insignificant to Sri Lanka, making up only 2percent of Sri Lanka's exports by value in the year 2016 (US\$ 215 million). In terms of importance, it ranks at the 8th place as an export market (Table 1). This flow has also seen a modest growth over the last few years, however not at the same rate as imports from China have seen. Weak export performance relative to imports from China is due to country's overall weak export performance (Abeyratne, 2017). The year 2016 has shown a decrease in the overall exports to China.

The largest exports from Sri Lanka by market value include textiles & apparel (34 percent of total exports to China) and tea (Figure 2). Other exports include: footwear/headgear, chemicals and transportation. Although overall China is not a key market for Sri Lankan exports, there are still certain export sectors which have not entered the Chinese market, providing a potential market for export growth. According to IPS, Sri Lanka has a comparative advantage in 565 products in the world (IPS, 2015). However, Sri Lanka is currently exporting only 243 products to China. Thus, there are almost additional 300 new products that can be potentially exported to China. Such export opportunities could provide some scope in addressing the growing trade deficit with China, which stands at US\$4 billion. The trade

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deficit with China has been growing year on year since the 1980s (Abeyratne, 2017).

Figure 4
Trade between China and Sri Lanka over the period 2001- 2016 (thousand)



Source: TradeMap Database.

While Sri Lanka has been actively engaging in all multilateral negotiations, Sri Lanka has entered into a few number of bilateral and regional agreements to date. Sri Lanka is a founding member of APTA, formerly Bangkok Agreement which is the oldest preferential trade agreement in Asia. China joined APTA in 2001.

Sri Lanka and China began negotiations on a FTA in November 2014 and so far a number of rounds have been completed. From the point of view of Sri Lanka, the FTA would provide better access to the biggest export market in the world with a population of over 1.3 billion as well as attract export oriented investments into the country, which would help Sri Lanka to penetrate the Chinese market.

A Joint Feasibility study on the FTA in 2015 stated that it would increase bilateral trade of particular interest of Sri Lanka such as tea, rubber, fish, textiles and clothing, coconut products, gems and jewellery, fruits and vegetables, machinery and electronics. While there are likely to be potential trade benefits from a FTA with China, there are a number of challenges in negotiating a FTA. These include: coverage of products under the agreement, speed of liberalisation programme, special and differential treatment, comprehensiveness of the Agreement; treatment of non-tariff measures (NTMs) in the Agreement (IPS, 2015). In addi-

tion, there are general issues that need to be addressed including increasing Sri Lanka's capacity to increase exports and undertaking policy reforms to strengthen the country's competitiveness and improve the investment climate in the country (Abeyratne, 2017).

CHINESE INVESTMENTS IN SRI LANKA

Sri Lanka performed poorly in attracting FDI till 2011, with annual flows under USD 1 billion. However, since then, there has been a significant uptick in foreign direct investment into Sri Lanka with a significant portion of that coming from China (as part of the Belt and Road initiative). FDI flows from China accounted for as much as 25 percent of total FDI in 2014 (Abeyratne, 2017). In the year 2015, China, Hong Kong, Mauritius, the UK and India were amongst the top five foreign investors in Sri Lanka; Chinese investment alone amounted to US\$ 990 mn, which accounted for 15.5 percent of total FDI during 2011-15 (Table 2). Chinese investments in Sri Lanka have been made in the following sectors: logistics, transport, and real estate (American Enterprise Institute and The Heritage Foundation).

Table 2
Major Source of Foreign Direct Investment in Sri Lanka, 2011-2015

	<i>US\$ Million</i>	<i>% of Total</i>
China	989.6	15.5
Hong Kong	798.7	12.5
Mauritius	576.6	9.1
UK	571.7	9.0
India	477.2	7.5
UAE	426.8	6.7
Malaysia	415.3	6.5
Netherlands	414.0	6.5
Singapore	385.7	6.0
USA	218.9	3.4
British Virgin Islands	137.0	2.1
Luxembourg	124.7	2.0
Japan	114.0	1.8
Canada	113.4	1.8
Australia	95.2	1.5
Switzerland	61.1	1.0
Total FDI	6381.5	100.0

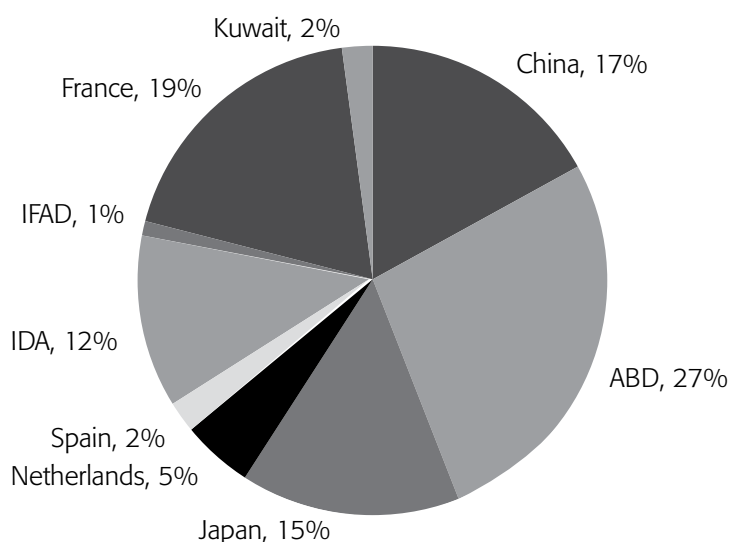
Source: Board of Investment in Sri Lanka as cited in Abeyratne (2017).

V. OTHER AREAS OF ECONOMIC COOPERATION

DEVELOPMENT ASSISTANCE TO SRI LANKA

China has provided development assistance to post independence Sri Lanka to support various development needs of the country (Jayasundara, 2017). Development assistance from China has come in three major forms, namely: loans, grants and interest free loans (Department of External Resources of Sri Lanka, 2016). (Loans are made out by the state owned enterprises such as the EXIM Bank, the China Development Bank (CDC) and Industrial and Commercial Bank of China (ICBC). Grants and interest free loans are provided directly by the Government of China through the Ministry of Commerce of China.

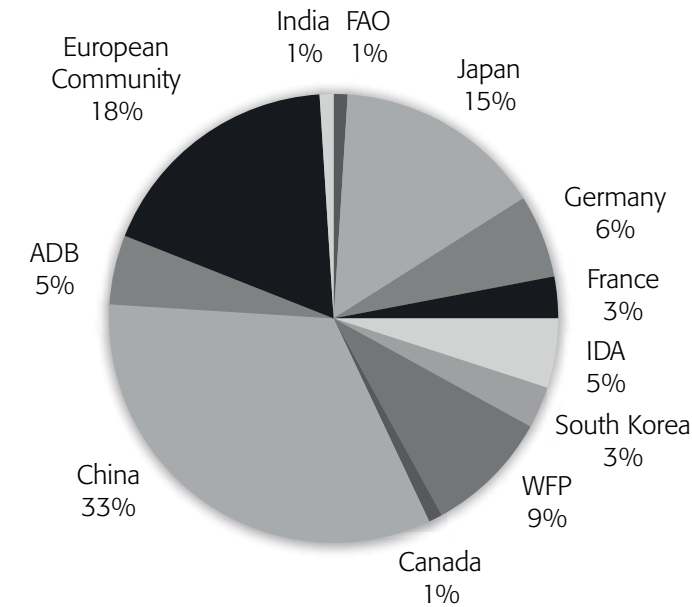
Figure 5
Loan Commitments 2016



Source: ERD (2016).

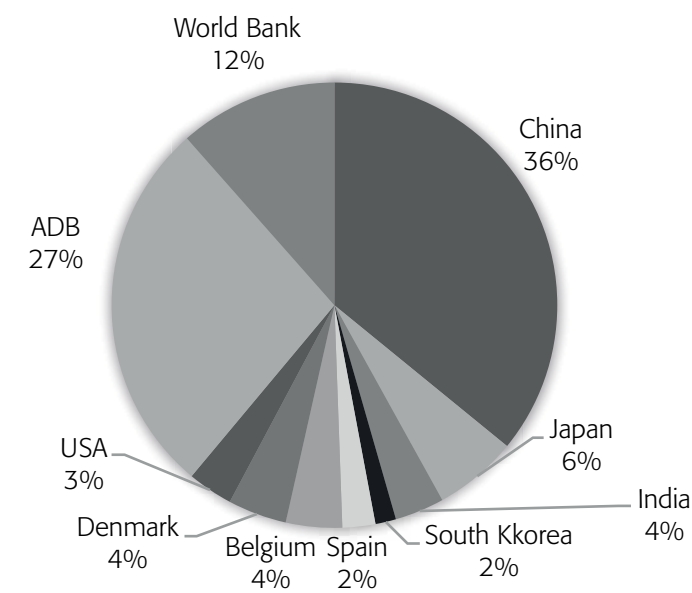
More recently, China has emerged as the largest provider of bilateral development assistance, overtaking Japan in 2010. Till 2010, Japan was the single largest bilateral lending partner of Sri Lanka (Jayasundara, 2017); the position has since then been taken over by China. Total commitment made from China for the last five-year period from 2012 to 2016 was USD 4,217.7 million (ERD, 2016). In

Figure 5
Grant Commitments 2016



Source: ERD (2016).

Figure 6
Total Disbursements 2016



Source: ERD (2016).

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2016, highest commitment by a bilateral donor was China, followed by France and Japan (Figure 5). Annual disbursement by China amounted to over US\$400 since 2012 (Jayasundara, 2017). Out of the total disbursement recorded from bilateral development partners during the year 2016, the major portion of the fund was disbursed by China (USD 440.8 million), followed by Japan and India, which contributed USD 74.4 million and 44.1 million, respectively (Figure 6).

A number of projects have been financed by China through loans for power generation, irrigation and water supply, port, airport, railways, expressways and highways (Jayasundara, 2017). A major portion of financial assistance provided by China consists of grant assistance. China has also become the leading contributor of grants in the year 2016 with 33 percent of the total grants received being from China, followed by European Community and Japan by recording 18 percent and 15 percent, respectively (Figure 5). The assistance from China mainly focus on the non-revenue generating projects such as public sector services (i.e. health sector and also other projects that are of historical importance to the relationship between the two countries such as Bandaranaike Memorial International Convention Hall [BMICH], Nelum Pokuna National Performing Arts Theatre and Superior Courts Complex). However, as a result of the substantial financial assistance provided for the implementation of various development projects, 9 percent of Sri Lanka's outstanding debt is to China as of 2016 (Department of External Resources of Sri Lanka, 2016).

TOURISM

Sri Lanka has become an emerging tourist destination among Chinese travellers and the Government of Sri Lanka hopes to attract at least 1 million Chinese tourists per year by 2020. Over the recent years, India has been the leading source market for tourism to Sri Lanka. Currently, China remains the second largest source market for tourism with the rapid increase of Chinese tourists since the year 2009. In 2016, there were 271,577 tourist arrivals from China, accounting for 13 percent of total tourist arrivals to the country (Table 3) compared to 17,013 arrivals from China five years back (Sri Lanka Tourism Development Authority, 2016). A majority of the Chinese tourists (90 percent) came for vacation, followed by visiting friends and family, business and MICE. On average Chinese tourist spends 9.5 days in the country; the average figure for tourists from Asia is 8.8 days which is lower than the figures for North America and Western Europe. This increase in Chinese tourist arrivals to Sri Lanka has been facilitated by more air connectivity between Colombo and opening up of a number of destinations in China, operated by airlines of both countries.

Table 3
Top Ten Source of Tourists to Sri Lanka, 2016

<i>Country</i>	<i>Total Arrivals</i>	<i>% of Total</i>
India	356,729	17.39
China	271,577	13.24
United Kingdom	188,159	9.17
Germany	133,275	6.5
Maldives	96,440	4.7
France	95,167	4.64
Australia	74,496	3.63
Russia	58,176	2.84
USA	54,254	2.65
Japan	44,122	2.15

Source: SLTDA (2016).

The growth rate of tourist arrivals shows the growing significance of China as a tourism partner of Sri Lanka. Chinese tourist arrivals grew by 72.5 percent in 2010-2016, while Indian and UK tourist arrivals increased by only 19.3 percent and 10.3 percent, respectively. However, Sri Lanka is not a top travel destination for Chinese tourist when compared to other countries. South East Asia, Japan and South Korea are the most popular destinations for Chinese tourists. Thus, there remains ample room for Sri Lanka to take steps to increase tourism from China. However, this should be matched by addressing challenges within the industry such as poor coordination among stakeholders, inadequate industry research, ineffective planning, inadequate human resource and infrastructure development, price competitiveness (Propelling Tourism in Sri Lanka, 2017).

As Sri Lanka- China ties continue to improve through the BRI initiative, tourism between the two countries has potential to further improve. With increased connectivity through BRI development in ports, airport and road networks along with the development in hotels and Colombo, the Sri Lankan tourism industry stands to significantly benefit.

VI. BELT AND ROAD INITIATIVES IN SRI LANKA

BRI has five major objectives, which includes policy coordination, connectivity, unimpeded trade, financial integration, and people to people contacts. Already with regards to connectivity, this has been met by China investing in a number of

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mega projects in Sri Lanka to develop the connectivity of Sri Lanka with the rest of the world. With regard to trade, currently China and Sri Lanka are negotiating a Free Trade Agreement (FTA). With regard to financial integration, Sri Lanka is already a member of AIIB. With regard to people to people exchange, there has been a number of cultural and academy exchanges between China and Sri Lanka over the years, as well as influx of Chinese tourists into Sri Lanka. This has furthered people to people bonds.

As mentioned earlier, the focus of the BRI programme is split between two main initiatives – a revitalised land route between China and Europe via Russia and the Maritime Silk Road which aims to connect a multitude of countries via new sea routes and infrastructure. Sri Lanka's involvements has largely been with the latter of these initiatives given Sri Lanka geographical location in the middle of the Indian Ocean, with an emphasis on Sri Lanka becoming a hub facilitating easy transit of goods from China to Sri Lanka and other South East Asian economies and beyond. Currently China's energy imports (from the Middle East) and mineral imports (primarily from Africa) pass through Sri Lanka (Palit, A., & Spittel, G. 2013).

To this effect, the majority of BRI investments in Sri Lanka have been to facilitate this maritime effort and a number of major infrastructure projects have been kicked off (Hillman, J.E. 2018). Under the BRI project, Sri Lanka has currently secured up to \$8 billion of financing from China. The Chinese Government and the China sponsored Asia Infrastructure Investment Bank (AIIB) have recently proposed additional funding of up to \$32 billion for further infrastructure projects (Economic Times, 2017).

Some of the notable BRI projects in Sri Lanka include:

COLOMBO INTERNATIONAL FINANCIAL CITY (CIFC)

This project (formerly known as the Colombo Port City) is an instrumental part of China's BRI and aims to build a new city and financial centre along the existing Colombo coastline that will serve as Sri Lanka's financial and business district by 2030. This development is meant to support the main port and provide the ancillary services that support the shipping industry including insurance, financial and logistical services (Ministry of National Policies and Economic Affairs, 2017). With an investment of US\$ 1.4 billion in the first phase of the project which includes reclaiming 269 hectares of land, and a planned second level building complex of US\$ 13bn, it is the largest FDI project in Sri Lanka to date. It is expected to create more than 80,000 jobs. After the change of government in Sri Lanka in 2015, its construction got suspended for more than a year.

HAMBANTOTA PORT AND ADJOINING INDUSTRIAL ESTATE

Sri Lanka is located at a strategic point for the BRI. The port of Hambantota is indispensable for China's energy security because the country imports two-thirds of its oil through shipping lanes south of the port (Nikkei, G.Y. and Palma, S., 2018). This initiative aimed to build a secondary port at the coastal town of Hambantota, to alleviate capacity and crowding concerns with the primary port in Colombo. The project was initially kicked off in 2008 by Sri Lanka on the basis on Chinese finance with the intention that Sri Lanka would operate the facility. However recently, China has taken over the project through providing additional funding and in turn taking a 70percent stake in the joint venture with the Sri Lankan Port Authority which holds the remaining shares.

In addition to this, the latest investment gives China control over 15000 acres of land adjacent to the port for the development of an industrial zone in Hambantota. The feasibility study for the industrial park identified the development of shipping services, processing of seafood, agricultural products and other processing/manufactured industries. (Shida, W. 2017).

COLOMBO PORT EXPANSION

Another BRI project in Sri Lanka is the expansion and modernisation of the Colombo port - the Colombo International Container Terminal, a Sino-Sri Lanka joint venture. The port, which serves as Sri Lanka's primary hub for freight has faced capacity concerns and as part of a joint venture with Chinese investors, construction of a new South Container Terminal was started in 2011 (Bloomberg, 2013).

MATTALA RAJAPAKSA INTERNATIONAL AIRPORT (MRIA)

The airport is located in Hambantota, 241 km south-east of Sri Lanka's capital city, Colombo. MRIA is the second international airport in Sri Lanka. Construction of phase one began on 27 November 2009 and MRIA was opened in March 2013; US\$209 million were spent on the project, with \$190 million provided by the Chinese government via the Exim Bank of China. A second stage of expansion was planned but has not commenced; it will expand terminal capacity from 1 mn to 5mn passengers per year (Airport Technology) but the project has proved to be an white elephant.

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OTHER INFRASTRUCTURE DEVELOPMENTS

China has also invested heavily in the development of other infrastructure projects in Sri Lanka. Examples include: the US\$460 million development of the Norochcholai coal power plant (Ministry of Power and Renewable Energy, 2017) to provide about 40 percent of the national's electricity supply (HE Cheng Xueyuan, 2018); the US\$250 Million Colombo-Katunayake expressway between the country's main airport and city facilitating travel and tourism industry (Ministry of Higher Education and Highways, 2017), Moragahakanda Project which is the biggest reservoir in Sri Lanka; Southern Railway and Expressway linking Colombo and Hambantota by the end of 2018. More recently, China has approved US\$1 billion for the funding of the phase one of the Central Expressway through a loan.

IMPLICATIONS OF BRI FOR SRI LANKA

This section aims to evaluate how the Belt and Road Initiative could potentially have a positive impact Sri Lanka. Concerns with the initiative are presented in the subsequent section.

BENEFITS OF BRI FOR SRI LANKA

BRI holds out the prospect of helping to bridge the significant infrastructure financing gap, increase connectivity, link local markets to regional and global value chains, and thereby increase trade and investment in the participating countries. BRI's impact can be framed in broad terms like trade, investment, tourism, and other flows between China and Sri Lanka.

TRADE

As the world's second-largest economy, China is one of the biggest traders in the world. While Sri Lanka is not an important trading partner of China, China has emerged to become Sri Lanka's second largest trading partner, after India in terms of Sri Lanka's total trade with the world. Initiatives, such as the BRI will enhance trade routes between both countries involved and facilitate trade bilaterally and beyond. Trade agreements have been placed under the BRI banner as well. Chinese officials have described a network of free trade agreements that would support the BRI, but to date, China appears primarily focused on bilateral trade deals. The FTA between Sri Lanka and China is expected to boost bilateral trade. According to the Feasibility Study Group of China-Sri Lanka Free Trade Agreement

identifies nine potential products which would benefit from a FTA with China. According to feasibility estimates, liberalisation of imports by China will increase exports from Sri Lanka by 3-112 per cent, depending in the export good/product.

The development of an industrial zone in Hambantota is likely to attract Chinese and foreign investment, boost jobs, tax revenues and the local economic base, contributing to expansion of bilateral and regional trade. The benefits of the maritime Silk Road stretch beyond infrastructure development by facilitating trade with new markets. The initiative focuses on increased cooperation between BRI countries which could help with the removal of trade barriers and promote regional trade and the formation of value chains.

INVESTMENT

Attracting more Foreign Direct Investment (FDI) is a priority for the Sri Lankan government. In countries like Sri Lanka, which has attracted limited investor interest in the past, BRI is a welcome development. As part of the BRI, there have been significant China investments in Sri Lanka. Existing investments in Sri Lanka as part of the BRI amount to approximately US\$8 billion, while China has offered up to an additional US\$24 billion in financing. The latest project to secure investment from the Chinese government is the building of a coastal rail link (HKTDC Research, 2018), and a \$500 million liquefied natural gas (LNG) plant near a Chinese-controlled port and industrial zone in (Reuters, 2018).

With increased trade and growth realised under BRI, there is anticipation that additional investments to Sri Lanka can be attracted. For example, Colombo Financial City once completed, is estimated to bring in over US\$13 billion in FDI. This can take the form of government led investment in infrastructure (as is the case with BRI) or as investment by private institutions. The outward investment can come from a combination of newly formed funds, such as the Asian Infrastructure Development Bank, the New Development Bank and Silk Road Funds, and from state-owned and private companies. Both of these approaches will enlarge the availability of capital, facilitating growth and further investment.

HARD AND SOFT INFRASTRUCTURE

Speaking at the OBOR Leaders' Roundtable, Prime Minister Wickremesinghe said: *"The Belt and Road Initiative will provide the much-needed hard and soft connectivity in the Indian Ocean region required for rapid economic and social development."*

BRI has created significant opportunities for countries and companies to participate in a range of projects, especially those involved in construction or infra-

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structural works. Asia's infrastructure is clearly in need of it: A recent ADB report highlighted 45 Asian countries should invest US\$26 trillion between 2016 and 2030 to fix their infrastructure shortfall (Deloitte, 2018). For countries needing infrastructure, the BRI holds the promise of investment in new railways, roads, ports and other projects, improving connectivity within and between countries.

To date, China has completed a number of infrastructure projects in Sri Lanka such as transportation, water, electricity, ports and etc. and have made important contributions to the socio-economic development of the country. For example, the introduction of the Katunayake Expressway connecting the city of Colombo to the airport has facilitated the faster transport of perishable goods (for example agricultural produce). The build-up of infrastructure as part of the initiative will ensure that not only will trade flow more freely, but rather local enterprises can leverage it to ensure domestic market access.

Fostering connections between Sri Lanka and China is important and should go beyond infrastructure links to include 'soft infrastructure'. The BRI aims at enhancing economic relations and people-to-people contacts by deepening cooperation on education, science, technology, sport, health, etc. For example, China granted more than 1200 scholarships, training programmes and internships to Sri Lanka every year since 2015(Xianliang, Y. 2017).

ECONOMIC HUB

Sri Lanka is striving to build itself as an economic hub in the Indian Ocean leveraging its strategic location and connectivity. Such a development goal is in line with the Maritime Silk Road. PM Wickremesinghe stated that Sri Lanka could be an economic hub within the BRI. BRI could open up the prospect of Sri Lanka becoming a major regional logistics and trading, and even production hub.

Currently, Sri Lanka's main Colombo port is classed as number 30 out of 145 ports globally. Top 20 shipping lines in Asia all dock at the Colombo Port. Sri Lanka has a significantly strong feeder connection to other ports in South Asia and Africa. These ports do approximately 30 percent of their trade via Colombo. The increased investment in capacity, port technology, warehousing and support services means that there is significant potential to attract new and larger shipping vessels, leading to significantly greater income for Sri Lanka.

In addition to Colombo, the Government has already commenced the development of the three major ports -Hambantota and Trincomalee, and the two international airports - Colombo and Mattala. These initiatives together with BRI will transform Sri Lanka into a logistics and trading hub. To support this, the new Colombo Financial City is being developed which aims to provide the support services including banking, brokerage, insurance, logistics and technology. Although

BRI is helping kick-start this development, the skills and service sector developed through this will also help serve numerous other sectors of the Sri Lankan economy. However making a success of the BRI will require more than just building physical infrastructure. Soft infrastructure is critical, which means facilitating the movement of people, goods and services across borders.

DEVELOPMENT OF GLOBAL VALUE CHAINS (GVCs)

The growth of global value chains (GVCs) has increased the interconnectedness of economies and led to a growing level of specialisation in specific activities and stages in value chains. According to a report by the OECD, WTO, and World Bank (2014), more than 70 percent of global trade is in intermediate goods and services while income generated within GVCs has doubled over the last 15 years. However, not all firms and countries are equally involved in GVCs. Some countries participate in many, either as the host country to lead firms or as suppliers of very specific tasks, while others participate very little. These varying degrees of connectedness across countries are determined by many factors, some of which are inherent to the country (country's geographic location and natural endowment), while others can be shaped by policy (country's human capital, infrastructure, and business environment). Thus, BRI can play an important role in the participation of Sri Lanka in global value chains and facilitate the easy exchange of goods and services through necessary infrastructure development.

GVC trade in the Sri Lanka continues to be dependent on a handful of medium sized investments. The manufacture of parts and components is significantly low compared to other countries and the country's share does not appear to be increasing adequately to keep pace with the rest of the world. Sri Lankan government has shown its enthusiasm to actively participate in global value chains development. Sri Lanka's basic manufacturing could be greatly improved once the Hambantota logistic and adjoining industrial zone is operated. Due to the extension of the maritime Silk Road to include regions as far as east Africa and Oceania, Sri Lanka will have access to diverse markets, which were previously difficult to access, providing the opportunity for increased product and service diversification.

GROWTH IN TOURISM

China has made it clear in its Vision and Actions document that tourism forms a key part of their plans for countries involved in the Initiative and will *"jointly create competitive international tourist routes and products; and make it more convenient to apply for tourist visa in countries along the Belt and Road"*. Tourism in

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Sri Lanka is already a major industry and great contributor to the economy (CEIC). Since 2010, Chinese nationals have made up a significant portion of the overall tourist population visiting Sri Lanka. The number of Chinese tourists visiting Sri Lanka between 2010 and 2016 has grown by over 70 percent and as of 2016 Chinese tourists make up approximately 15 percent of all the tourists coming to Sri Lanka (Deyshappriya, N.R.R, 2017). As the Initiative gains traction in the region, its impact will be crucial in helping even more tourists from China and neighbouring countries to Sri Lanka facilitated by increased trade and business between Sri Lanka and BRI countries.

DISCOVERY AND UTILIZATION OF MARITIME RESOURCES

Better maritime infrastructure will mean that Sri Lanka can explore and exploit sea found natural resources that fall within Sri Lanka's Exclusive Economic Zone (a radius of 200 miles around the island). If significant deposits of commodities or natural resources are found within this zone, better maritime infrastructure (specifically the Hambantota and Colombo ports), better trading relations and routes with countries and increased cooperation with other countries due to better knowledge transfer (brought about by the Belt and Road initiative) will make these natural resources more exploitable and marketable.

TECHNOLOGY AND KNOWLEDGE TRANSFER

One of the key objectives of BRI is to promote the transfer of knowledge and expertise between countries participating in the programme. Towards this end, a university alliance has been set up by China to facilitate policy, research, cross-cultural understanding and training between institutions in countries participating in the BRI (Lie, M., 2016). In addition, through the development of value chains and trade/investment flows, significant knowledge transfer will take place, which can then be disseminated locally, laying the foundations for sustained economic progress.

EMPLOYMENT OPPORTUNITIES

Both through the direct efforts involved in the construction of new infrastructure and through the creation of new service industry jobs and increased trade, it is envisaged that the BRI will boost employment within Sri Lanka. For example, the new financial city is forecasted to provide 80000 new jobs when completed. (Xinhua State News Agency, 2017).

VII. POTENTIAL CONCERNS AROUND BRI FOR SRI LANKA

POWER RIVALRY

Currently, Sri Lanka is walking a tight rope: seeking economic and other benefits from China under BRI while maintaining close relations with its rivals, the US, Japan and India. (Ramanayake,P. ,2017), As the biggest country in South Asia, India has been watching China's activity in Sri Lanka and elsewhere in the region with concern. BRI has raised concern of China's intentions in the Indian Ocean given the ambitions of the plan. Not surprisingly, India is not a party to the BRI. India together with Japan, who are concerned about the strategic implications of China's economic expansion, did not attend the summit held on BRI last year (Stanzel, 2017). In fact, India openly rejects the BRI, saying China's projects with neighbouring Pakistan infringe on its sovereignty. India sees China's investments in the ports and infrastructure across South Asia as a defence threat or part of the so-called 'String of Pearls' strategy, according to which China will take advantage of ports in the Indian Ocean (Gwadar in Pakistan, Chittagong in Bangladesh, Kyaukpyu in Myanmar) to contain India. From this perspective, China's investment in Sri Lanka especially in the ports of Colombo and Hambantota are seen of strategic importance. For example, the docking of a Chinese submarine at the port of Colombo in 2014 and the handover of a port at Hambantota in December 2017 raised alarms in Delhi.

In addition to India, the West and Japan have been observing China's increasing presence in Sri Lanka and its involvement with the BRI under with the Rajapaksa administration with concern, prompting the new elected government in 2015 to rebalance its relations with India and West. The strategic location of Sri Lanka at the centre of the Indian Ocean has trapped Sri Lanka in the power rivalry involving major economic powers such as the USA, India, China, and Japan.

AUTONOMY AND INDEPENDENCE

With a significant portion of investment and funding in BRI coming from Chinese public entities, there is concern of Sri Lanka's growing debt burden and loss of sovereignty. There is concern that due to the ownership of key central infrastructure (e.g. the ports) being tied to such entities, Sri Lanka sacrifices a level of autonomy around how to manage these infrastructures. In Sri Lanka, China's takeover of a troubled Hambantota port raised questions about a loss of sovereignty.

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GROWING DEBT BURDEN

As part of BRI and due to the increased funding and loans made available by China, Sri Lanka has inherited a significant amount of debt to China and rest of the world. Sri Lanka's debt equals 81.6 percent of its gross domestic product, which the International Monetary Fund says is the third-highest ratio among emerging economies. China is currently Sri Lanka's largest creditor (Legrand, 2018). The Sri Lankan government has had difficulty making repayments on some of these debt obligations and has had to restructure the debt agreements with the Chinese government. A prominent example of this is the funding around the Hambantota port. In 2008, former Sri Lankan President Mahinda Rajapaksa ordered the construction of the Hambantota Port. Due to the inability to repay the \$1.4 billion loan from China, the Sri Lankan government has granted the Chinese government an exclusive 99-year lease on the Hambantota port in exchange of US\$1.1 billion of debt write off (New York Times, 2018).

TRANSPARENCY AND CORRUPTION

There has been international criticism of BRI's potential to generate huge levels of corruption. Given the limited oversight (by design) and the projected speed of development, as well as the countries and industries involved, businesses working on these infrastructure projects can face bribe demands. According to the 2017 TRACE Bribery Risk Matrix, which measures business bribery risks in 200 countries, BRI countries show comparable patterns of bribery risk: China and Sri Lanka rank at 158th and 159th out of 200 countries. Coupled with overall country risks are the risks specific to the industry: 30 percent of cross-border bribery cases are in the construction and transportation sectors, and some estimate that between 10 and 30 percent of investment in publicly-funded construction projects may be lost due to corruption. Despite its stated desire for a "clean belt and road," China's past indifference to the payment of bribes beyond its borders by Chinese companies is not encouraging.

LOW INVESTMENT RETURN

Often infrastructure projects are driven more by political considerations than commercial needs. The lack of commercial imperatives behind [BRI] projects means that it is highly uncertain whether future project returns will be sufficient to fully cover repayments to Chinese creditors (Zhou,J.Hallding,K.Han,G, 2015). A case in point is the Mattala Rajapaksa International Airport (MRIA), located in the town

of Mattala, serving southeast Sri Lanka. . MRIA which was opened in March 2013 by President Mahinda Rajapaksa has failed to attract business (Samarajiva, 2017). Initially, several airlines flew to the airport, including SriLankan Airlines. However, due to low demand, most of these airlines left Mattala. As of June 2017, two airlines fly from the airport to destinations within Sri Lanka and the United Arab Emirates.

Due to the low number of flights, it has been proposed to offer long-term aircraft parking services as well as creating flying schools and maintenance services to be offered from the airport. In 2016, the Sri Lankan government called for Expressions of Interest to run commercial activities as the airport is not generating enough revenue to pay back the loans. It has been called “the world’s emptiest international airport” due to its low number of flights.

PUBLIC PERCEPTION AND OPPOSITION

There has been some negative reception to BRI, largely due to the amount of debt that has been undertaken by Sri Lanka and the loss of its autonomy. There have been a number of occurrences of public unrest, most recently rioting in the port city of Hambantota to express dissatisfaction with the loss of land; the government’s handling of the debt repayment and the leasing of the port to China (Al Jazeera News, 2018). The Hambantota project failed to account sufficiently for local feelings about the development, concerns about political corruption, and national and regional political and security worries (Deloitte, 2018).

POLLUTION AND SUSTAINABLE GROWTH

Currently, the focus of the BRI programme has been to rapidly scale out key infrastructure that is instrumental to trade, including ports, industrial zones and roads. To date, there have been limited studies to evaluate the long term environmental impact of these infrastructure projects. While the Environmental Impact Assessment (EIA) of the Colombo Port City shows that there is negligible impact from the construction, some have raised concerns around negative impacts due to the mining required for landfill and for marine life due to the reclamation of land for the project (Sivaram, K., 2017).

Moreover, there is concern that some of the other investment through BRI has been towards rapidly scaling out energy production heavily dependent on fossil fuels. Examples in Sri Lanka include funding of the Puttalam Coal Power Project. Concerns have been raised that these long term projects could breed a culture of

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fossil fuel dependence and dissuade investment in greener and more sustainable alternatives (Pike, L., 2017).

CHANGES IN GOVERNMENT AND POLICY

After initial fanfare, projects sometimes experience serious delays. In Indonesia, construction on a US\$6 billion rail line is behind schedule and costs are escalating. Similar problems have plagued projects in Kazakhstan and Bangladesh. As changes in government and policy occur frequently, there is concern that new governments may not agree to or honour commitments made by previous ones, as it was seen in Sri Lanka. The Sirisena-Wickremesinghe government took immediate steps to suspend a number of major Chinese-funded projects inaugurated during Rajapaksa's rule after coming into power. Within months, however, government not only restarted the projects, including the CIFC/Colombo Port City, but requested new investments from China to overcome acute balance of payments and debt problems. In such instances, politically motivated decisions could thwart investment and confidence in Sri Lanka.

VIII. MAXIMIZING THE OPPORTUNITY OF BRI

BRI is seeking to rebuild China's ancient silk routes for the 21st century by building new connections across three continents. This is cross-border ambition on an unprecedented scale, at a time when globalisation and free trade are under threat in some regions. Under the BRI, China will build railways and highways, aviation links, oil and gas pipelines, transmission lines and telecommunication networks that will bring together many countries in Europe, Africa, and Asia and benefit millions of people.

BRI's success and its ability to foster connections between Sri Lanka and China will require more than just building physical infrastructure. Soft infrastructure is critical, as well as structural reforms and improvements in trade policy and investment climate in the country to better integrate into international value chains. The provision of funding alone is not enough to overcome the fundamental challenge of identifying environmentally sustainable and financially viable projects. Projects could fail as a result of poor investment decisions due to political priorities overriding economic considerations. The wrong kind and scale of infrastructure investment can lead to difficult debt situations. Or projects that offer insufficient returns to the communities could result in political backlash. As Sri Lanka engages with the BRI, it needs to address these risks as well as balance Sri Lanka's relationship with China and other major powers with an interest in the Indian Ocean.

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