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China - Sri Lanka Strategic Hambantota Port Deal

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Introduction

Sri Lanka is conscious of its geostrategic position, and the advantage its ports hold in the Indian Ocean Region. One such port is the Hambantota Port, situated along one of the world's busiest east-west shipping routes, which passes 10 nautical miles from Hambantota. The island country holds the potential to become an advanced commercial hub so as to accelerate the country's economy and trade, with the help of infrastructural investment from foreign entities like China.

China has already invested USD 2 billion on the Hambantota Port Development Project. These investments were made without any feasible study or consideration of other repayment options. The port's existing economic non-viability, massive maintenance expenses, and huge interest payments have led to a serious 'debt trap' for the island country. In December 2006, the initial agreement between the two parties was signed; wherein the Sri Lankan government was expected to sell 80 per cent stake in the Hambantota port for a 99-year lease, for USD1.12 billion.

This issue brief aims to trace the development of the Hambantota Port Development Project vis-a-vis the degrading economy of Sri Lanka. It further examines the implications of the proposed agreement on the security, politics, and society of Sri Lanka. It also attempts to analyze China's intentions behind the huge non-viable investment.

Background

The Hambantota port is an initiative of the Lankan government to further develop the strategic port and proposed industrial zone of 1,235 acres. The port project is financed and constructed by the China Merchants Port Holdings Company Limited (CMPHCL), a fully Chinese government owned enterprise. The CMPHCL owns Colombo International Container Terminal Limited (CICT) which, apart from developing the Hambantota Port, also operates the Colombo South Terminal through a 35-year Build-Operate-Transfer agreement.[1]

In 2005, a Danish Consultancy organisation conducted a study of the construction of the Hambantota Port. The development project is divided into three phases. Phase – I of the development project have already been completed, and is now operational. The construction of the Phase – I was estimated to cost USD 360 million, with 85 per cent of funding from China Exim Bank and the balance 15 per cent by the Sri Lankan Port Authority (SLPA). In addition to the loan, the country had to incur additional expenses such as payment to the Danish consultancy, the cost of land attained for construction, payment of fluctuating equipment costs, etc.

The construction work of Phase - II of the project is substantially completed.[2] Phase – II is estimated to cost around USD 750 million. The development project also includes an artificial island, built with the excavated material from Phase – II of Hambantota port. The island is located within the boundary of the port development area and has an approximate area of 43 Hectares.

Phase – III of the development project was expected to be completed by 2023, but future development appears to be on stalled.[3] The phase-wise summary is tabulated below:

Phase	Construction Commenced	Work Completed	Estimated Cost (USD)	Status
Phase - I	January 2008	November 2010[4]	650 Million[5]	Currently Operational
Phase - II	November 2012[6]	-	810 Million[7]	In progress
Phase - III	-	2023	-	Future Development

Table 1. Phases of Hambantota Port Project

Chinese Debt Trap

Hambantota port has incurred heavy losses, with regard to its ongoing maintenance expenses, debt servicing installments, and interest payments. The total debt of Sri Lanka stands at USD 64.9 billion approximately, of which USD 8 billion is owed to China.[8] For the Hambantota Port project alone, Sri Lanka had borrowed USD 301 million from China, at an interest rate of 6.3 per cent.[9] This huge debt resulted from the decisions of the erstwhile Rajapaksa government, which had obtained the loans for large- scale infrastructure development projects from China without adequate assessment of its implications. Later in 2015, the Siresena administration inherited this debt.

Unable to generate revenue from the failed project and with a huge loan to repay, the island country has fallen into a debt trap, leading Sirisena administration to enter into an agreement with CMPHCL. The Sirisena administration is of the view that the only feasible arrangement is to convert loans into equity to ease some debt it owes to China.

Proposed Way Ahead

On December 2016, the first agreement was signed between the two parties, i.e. the SLPA and CMPHCL signed their first agreement. The agreement laid down that the Sri Lankan government would sell 80 per cent shares of the Hambantota port (USD1.12bn) for a 99-year lease, to the Chinese company. The remaining 20 per cent of the shares were to be held by the SLPA. The total land leased includes the entire port infrastructure, industrial zone, an artificial island and naval area, which were constructed on the port property. According to the Finance Minister of Sri Lanka, Ravi Karunanayake, the problem can only be solved by first settling high-interest loans, through the proceeds of the Hambantota sale.

On 21 March 2017, the agreement witnessed an unexpected change in its content due to extensive and violent protests and demonstration by the Sri Lankan citizens, with regard to the sale of 80 per cent of the port and the proposed industrial zone. The Sri Lankan Cabinet approved the renegotiated agreement, which aimed at reducing the current stake of China in the port project. The revised proposed agreement stated that the Chinese company shall agree to divest a maximum of 20 per cent from its initial shareholding of 80 per cent, within a decade to other Sri Lankan enterprises.

According to Sri Lankan Prime Minister, Ranil Wickremesinghe, the yet to be signed agreement, will create a fair balance between the two parties.

Although Hambantota is a ‘free port’, global shipping companies have refused to use it due to reasons of economic viability. The issue of economic viability is being addressed with the investment of USD 5 billion by the Chinese investors, in the proposed 15,000-acre industrial zone for setting up of Chinese factories. These industries may later re-export goods to China through the proposed Free Trade Agreement (FTA).The Prime Minister of Sri Lanka is expected to visit Beijing in May this year to discuss the issue with China.

The sale of stakes in Hambantota will not only help Sri Lanka to pay its debt but will help manage its foreign currency reserves.

Implications of the Agreement

Conversion of the loan into equity by the Lankan government might help the country to overcome the economic debt trap; but at the same time, it could compromise national security and domestic stability of the country.

Security: The joint venture shall give various rights to the Chinese company, such as development and operating rights for port-related commercial activities, allowing direct control over the shipping movement, port security services, bunkering, inner anchorage service, ship repairing, etc.

As per the latest draft of the agreement revised on 25 March 2017, the overall security of Hambantota Port will be controlled by an Oversight Committee, comprising representatives of the Sri Lankan Navy, Sri Lankan Police, SLPA and the Secretary to the Ministry of Strategic Development and International Trade. However, the internal security of the port will be controlled only by the Chinese company, thus providing a loophole to Chinese employ the military for the internal security role. Therefore, the Lankan government has indicated that such an arrangement will require substantive changes in the law with regard to the port and it would neither affect the sovereignty of the country nor lead to any inimical military presence.

Political: The island country has been facing continuous and frequent allegations of corruption, stemming from the unilateral Chinese investment in the country. Foremost, among those in permitting the Chinese company to secure the vast infrastructural projects without a bidding process.[10] It also led to the widespread perception of the former Rajapaksa administration having a pro-China tilt. The Rajapaksa period saw the signing of numerous non-viable commercial infrastructural projects with the Chinese companies. These infrastructural projects not only share the former President's name but are also situated in his hometown of Hambantota district. The following table showcases the various infrastructural projects Chinese company invested during the Rajapaksa administration.

Project	Investment
Mahinda Rajapaksa National Tele Cinema Park	2 Billion Sri Lankan Rupees
Mahinda Rajapaksa International Cricket Stadium	700 million Sri Lankan Rupees
Norochcholai Power Plant	USD 1.35 billion
Southern Expressway	776 Billion Sri Lankan Rupees
Mattala Rajapaksa International Airport	26 billion Sri Lankan Rupees

Table 2. Chinese Infrastructural Investments during Rajapaksa Period

The current Sirisena administration has announced that the Chinese investment undertaken by the previous administration will be reassessed and canceled, if it lacked proper clearances. The abrupt suspension of the Colombo Port City Project in March 2015 is a case in point, even though it was revived again in March 2016. The Sirisena administration stands helpless, as the government can neither terminate the project midway nor are they able to pay compensation. The only practical option is to convert the loan into equity. However, the joint opposition led by Rajapaksa, has suggested that the country's strategic assets must remain in the hands of the government; and if needed, the country should acquire major stake rather than just 20 percent.

Social: Hambantota is considered to be located one of the poorest regions of Sri Lanka. The port development project was conceived to be a catalyst for major social development, through employment generation. However, China is known to be sending its own casual labour, leading to a reduction in local employment opportunities.

In January 2016, a number of violent demonstrations, protests, and rallies surfaced against the port deal with China. On 6 December 2016, a satyagraha campaign was also launched by the Hambantota workers, who were at the risk of losing their livelihood. The protesters feared that the land provided by the government for the proposed zones will soon become a 'Chinese colony', leading to erosion of culture and demographic changes, apart from the prevailing resettlement issues.

China's Investment in Hambantota

China has been investing in economically non-viable projects of Sri Lanka, essentially to gain negotiating leverage. This chequebook diplomacy has left the island country in an unenviable crisis situation. For now, China has already invested almost USD two billion on the port project. If the proposed agreement is inked, China will have to invest at least USD 700 million to operationalise the port completely.

China excels in the art of using financial assistance to advance its strategic interests, especially in developing countries. The Hambantota port is a classic example of Beijing's ambitious plans to create a lucrative outpost in the Indian Ocean Region, to secure its oil supplies and further its exports to South Asia, East Asia, Africa and Europe. It also supports its One Belt, One Road (OBOR) initiative, designed to connect the Eurasian Landmass by land and sea. Chinese President Xi Jinping has called Sri Lanka 'vital' to the completion of the country's OBOR initiative.[11] Countries like Laos and Pakistan also complement the initiative and have already indulged in heavy Chinese funding. Beside the Hambantota port, China has been investing in other non-viable projects, such as the Mattala Rajapaksa International Airport, uncharitably famous as the 'world's emptiest international airport'.

Implications for India

The Sirisena administration will soon need to balance its approach vis-à-vis other regional countries. This is especially necessary to maintain peace and harmony in a region which is witnessing increasing geopolitical rivalry. The award of the port to China has not been viewed favorably by India, in the immediate neighbourhood. Sri Lanka cannot afford to alienate India any further. Colombo's proposal to India to develop the north- eastern port of Trincomalee is a case in point.

Conclusion

The yet-to-be-signed renewed agreement provides the Chinese company with unilateral powers, affecting both, the domestic and economic matters of the country. Therefore, the port being a strategic asset should remain in the hands of Sri Lanka, and the government should have a proprietary right over it, else it could legally be used as a stating base for Chinese naval ships and submarines operating in the IOR. The Chinese holding operational rights might also affect the business of the Colombo port economically.

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Notes

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