

Research Paper

Ganeshan Wignaraja, Dinusha Panditaratne, Pabasara Kannangara
and Divya Hundlani

Asia-Pacific Programme | March 2020

Chinese Investment and the BRI in Sri Lanka



**CHATHAM
HOUSE**

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Summary

- China's expansive Belt and Road Initiative (BRI) has led to greater Chinese outbound investment in Asia, including in Sri Lanka. This investment has recently come under scrutiny, due to intensifying geopolitical rivalries in the Indian Ocean as well as Sri Lanka's prime location and ports in the region.
- There are claims that by accepting Chinese outbound investment, Sri Lanka risks being stuck in a 'debt trap' and the displacement of its local workers by both legal and illegal Chinese labour. There are also concerns that Chinese investment has led to environmental damage and increased security risks for Sri Lanka and the neighbourhood. Furthermore, there is criticism that institutional weaknesses in Sri Lanka, including a lack of policy planning and transparency, are resulting in nonperforming infrastructure projects funded by Chinese investment.
- The pattern of Chinese investment in Sri Lanka reveals a nuanced picture of benefits and costs. Similarly, it shows that a matrix of Sri Lankan, Chinese and multilateral policies are required to maximize the benefits and minimize any risks of Chinese investment. Sri Lanka is not in a Chinese debt trap. Its debt to China amounts to about 6 per cent of its GDP. However, Sri Lanka's generally high debt levels show the country needs to improve its debt management systems. This step would also reduce any risk of a Chinese debt trap in the future.
- Specific projects have contributed positively to Sri Lanka's economy. Some have brought greater benefits than others, such as the Colombo International Container Terminal (CICT), which has allowed the Colombo port to grow at a rapid pace. However, imports from China for projects in Sri Lanka have widened the trade deficit between the two countries. In addition, there have been only limited economic spillovers for Sri Lanka, including knowledge transfer in the local labour force.
- The number of Chinese workers in Sri Lanka is rising but remains a very small percentage of the total labour force. While illegal migration is a concern, there are significantly fewer illegal residents from China than from neighbouring countries. Sri Lanka has relatively strong rules on outward migration but can better regulate inward migration based on labour market demands and economic priorities.
- The environmental implications of Chinese investment projects in Sri Lanka are mixed. While earlier projects were more harmful, recent projects such as the CICT and Port City in Colombo have adapted to stricter environmental standards. To ensure consistently high environmental standards, Sri Lanka should strengthen its domestic regulations and seek more investments from green-friendly partners.
- Concerns that China will use ports and other projects for military purposes are, in part, driven by geopolitical anxieties. In response, Sri Lanka has strengthened its naval presence at the Hambantota port. Continual oversight by technical experts is required to guard against security-related concerns and ensure public trust in the projects. Such trust will also grow by improving transparency and by pursuing a long-term, national infrastructure development plan.

1. Introduction

China's Belt and Road Initiative (BRI) – the largest transcontinental infrastructure scheme in the history of economic development – is having profound impacts on recipient countries. There is growing media and policy interest in the experience of Sri Lanka because of its strategic geographical location along East–West sea lanes, India's security concerns regarding Chinese military presence in the Hambantota port, and claims that Sri Lanka has fallen into a Chinese 'debt trap' due to commercial financing of BRI projects. Yet there is an absence of research based on local primary sources of information.

To fill this research gap, Chatham House commissioned a study of Chinese outbound investment and the BRI in Sri Lanka. The study, which is the basis for this paper, focused on several issues concerning Chinese infrastructure investment in 2006–19 including economic aspects and implications for labour, the environment and institutions. This paper examines the broad benefits and costs of the BRI and its projects to Sri Lanka and the lessons that may improve future BRI projects in Sri Lanka and elsewhere. It adopts an evidence-based approach, carefully reviewing the available data and perceptions of stakeholders, to discern salient facts and trends from popular misconceptions. A novel feature of the study was the extensive collection of original information through field visits to project sites and interviews with a range of stakeholders in Sri Lanka.

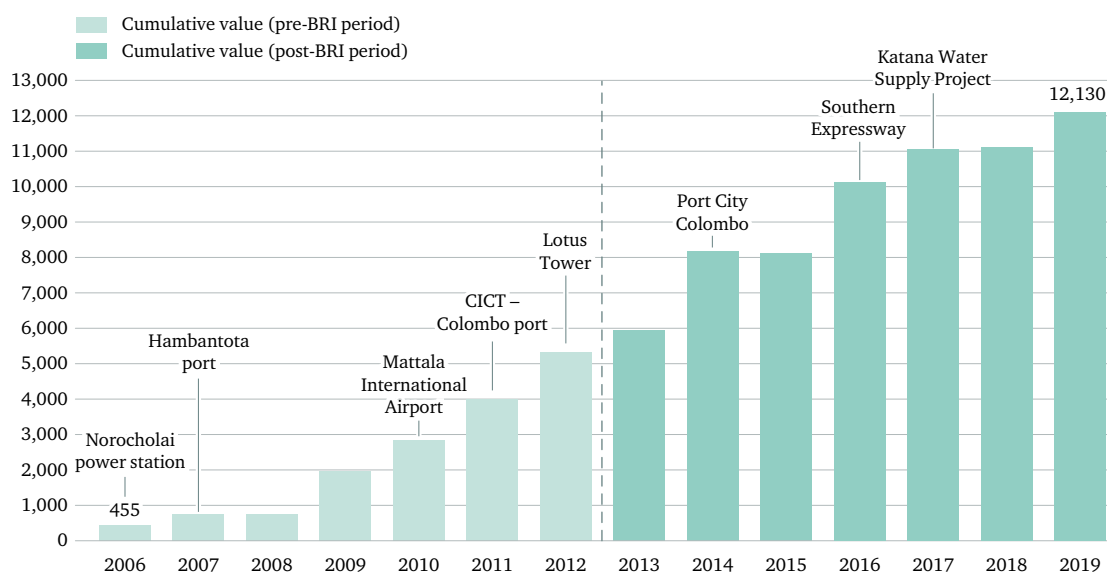
The study reports that the cumulative value of Chinese infrastructure investment to Sri Lanka amounted to \$12.1 billion between 2006 and July 2019. The crucial development challenge for Sri Lanka is how best to maximize the benefits from Chinese infrastructure investments while minimizing any potential costs to ensure net benefits across the project portfolio. Meanwhile, China's challenge is how to further its reputation as a responsible global economic partner. It has begun to address this challenge through growing public diplomacy initiatives and nascent regulatory changes.

The Sri Lankan experience of Chinese infrastructure investment offers useful lessons for other developing country recipients of Chinese investment. But as countries differ in their institutional and policy conditions, insights from the Sri Lankan experience are also valuable to individual national circumstances elsewhere in the developing world.

2. Economy

China’s first infrastructure investments in Sri Lanka took place in the 1970s in the form of outright grants, which included the construction of a convention centre.¹ In the early 2000s, grant-based relations were upgraded to a commercial model that utilized interest-bearing loans and infrastructure-related foreign direct investment (FDI). As a result, the administration of President Mahinda Rajapaksa (2005–15) initiated important transport, energy and telecommunications projects with Chinese support – including the coal-fired Norocholai power station in 2006, the Hambantota port in 2007, the Mattala International Airport in 2010, the Colombo International Container Terminal (CICT) at the Colombo port in 2011, and the Lotus Tower in 2012 (see Figure 1).

Figure 1: Value of Chinese development finance to Sri Lanka (\$ million)



Source: Calculations based on data provided by the Central Bank of Sri Lanka, Department of External Resources, Ministry of Finance, Sri Lanka; Board of Investments, Sri Lanka, and various interviews with key persons.
 Note: The chart shows committed funds only up to July 2019.

China announced the BRI in 2013. In Sri Lanka, projects that could conceivably come under the BRI umbrella began with the Colombo Port City development (located near the Colombo port, but otherwise unrelated to it) in 2014, which was followed by several road and expressway projects, water and sanitation projects, and further investments in existing projects such as the revised Hambantota port deal in 2017.

¹ For instance, the iconic Bandaranaike Memorial International Conference Hall (BMICH), inaugurated in Colombo in 1973, was a Chinese gift to Sri Lanka emulating the design of the Great Hall of the People in Beijing. The two countries had enjoyed a warm relationship since Sri Lanka recognized the People’s Republic of China (PRC) in January 1950 and supported China’s accession to the UN. These developments and the historic barter trade deal – the Ceylon–PRC Rubber-Rice Pact of 1952 – led to China gifting the BMICH to Sri Lanka. See Asirwathan, G. (2018), ‘China-Sri Lanka Relations in the 20th Century’, LKI *The Prospector* blog, 24 December 2018, <https://www.lki.lk/blog/overview-of-sri-lanka-china-relations/> (accessed 3 Feb. 2020); Wignaraja, G. (2019), *Grappling with Great Power Rivalries: Reflections on Sri Lanka’s Engagement with the United States and China*, Working Paper, Berlin: Stiftung Wissenschaft und Politik, https://www.lki.lk/wp-content/uploads/2019/12/BCAS_2019_Dr_Ganeshan_Wignaraja_Sri_Lanka.pdf (accessed 3 Feb. 2020).

What is the scale of Chinese investment in Sri Lanka?

While data on high-profile projects, such as Hambantota port, are available from national sources,² there is no reliable estimate of cumulative Chinese infrastructure investment in Sri Lanka to date. Nor is there an official definition of what constitutes a BRI project in Sri Lanka. The media sometimes equates BRI projects as hard infrastructure like ports and airports, while at other times the focus is on soft infrastructure like cultural exchanges. Quantifying Chinese investment and the BRI in Sri Lanka is thus a challenging task.

Box 1: Scope of Chinese investment in this paper

- **Transport**, including roads and expressways (e.g. the Southern and Central Expressways), railways, ports (e.g. the Hambantota port) and airports (the Mattala International Airport);
- **Energy and extractives**, including non-renewable energy generation (e.g. the Norocholai power station), renewable energy from hydro power, and energy transmission and distribution;
- **Water and sanitation** (e.g. the Kandy North Pathadumbara water supply project);
- **Urban development** (e.g. the Colombo Port City project);
- **Info and communications**, including ICT infrastructure (e.g. the Lotus Tower).

Note: Excludes hard infrastructure investment linked to cultural projects (e.g. the Nelum Pokuna Auditorium in Colombo and the Mahinda Rajapaksa Convention Centre in Hambantota) and defence-related infrastructure. It also excludes soft infrastructure items like trade deals, trade facilitation agreements, and people-to-people exchanges (e.g. tourism, education, military and cultural exchanges). As these items are relatively small in number, excluding them is unlikely to matter much to our estimate of cumulative Chinese infrastructure investment in Sri Lanka.

Analysis for this paper suggests that the value of cumulative Chinese infrastructure investment in Sri Lanka amounts to \$12.1 billion between 2006 and July 2019 or equivalent to 14 per cent of Sri Lanka's 2018 GDP (see Figure 1). There was only a modest rise from \$5.4 billion in the pre-BRI period (2006–12), which accounted for roughly 15 projects, to \$6.8 billion in the BRI period (2013–19) with 13 projects. Furthermore, as shown in Figure 2, Sri Lanka's economic reliance on Chinese infrastructure investment is less than other poor economies in neighbouring South Asia like Maldives (equivalent of 15 per cent of GDP) and Pakistan (16 per cent) and in Southeast Asia like Cambodia (40 per cent) and Laos (117 per cent).³

Chinese investment and meeting Sri Lanka's infrastructure investment gap

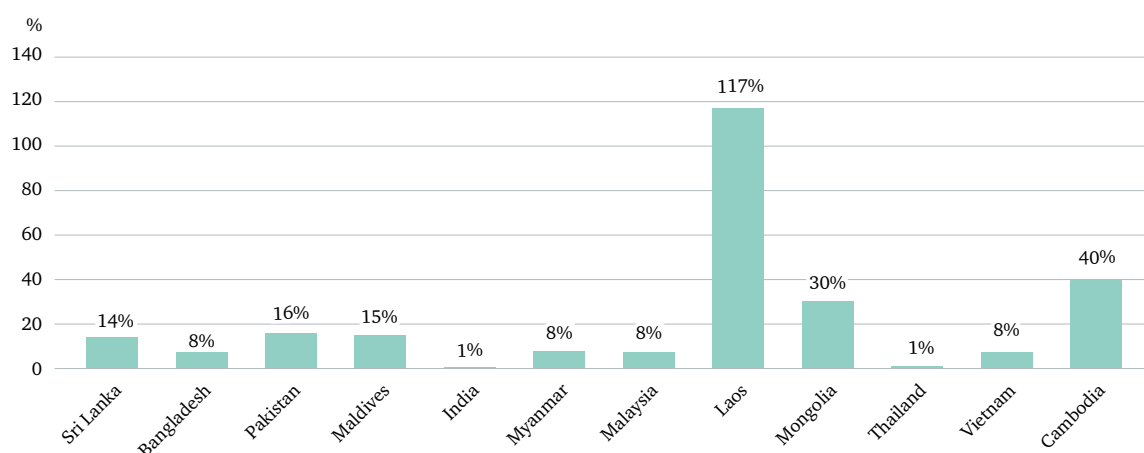
When analysing the benefits of Chinese infrastructure investment in Sri Lanka it is important to understand the baseline of infrastructure development (including the performance of national infrastructure and total national infrastructure investment needs) and the contribution of Chinese investment towards improving national infrastructure development. This can be gleaned

² Central Bank of Sri Lanka (2020), 'Annual Reports 2009–18', <https://www.cbsl.gov.lk/en/publications/economic-and-financial-reports/annual-reports> (accessed 3 Feb. 2020); Department of External Resources, Ministry of Finance (2020), 'Official Development Assistance Database', http://www.erd.gov.lk/index.php?option=com_content&view=article&id=89&Itemid=312&lang=en (accessed 3 Feb. 2019); Board of Investment of Sri Lanka (2020), 'BOI publications', <http://investsrilanka.com/news/boi-publications/> (accessed 3 Feb. 2020); and primary data from interviews with key persons.

³ Calculations based on data from American Enterprise Institute (2019), 'China Global Investment Tracker', <https://www.aei.org/china-global-investment-tracker/> (accessed 3 Feb. 2020); International Monetary Fund (2019), *World Economic Outlook: Global Manufacturing Downturn, Rising Trade Barriers*, Washington, DC: IMF, <https://www.imf.org/~media/Files/Publications/WEO/2019/October/English/text.ashx> (accessed 3 Feb. 2020).

by using secondary sources and interviews with key stakeholders involved in Chinese projects and government officials.

Figure 2: Total Chinese investment as a % of destination country’s GDP (2018)



Source: LKI calculations based on data gathered from the American Enterprise Chinese Investment Database and the IMF, World Economic Outlook Database.

Note: Cumulative investment 2006–18/GDP of respective country in 2018.

The World Economic Forum’s *Global Competitiveness Report 2019* uses a comprehensive set of indicators to rank overall performance of infrastructure in 141 economies in the world including Sri Lanka.⁴ The data reproduced in Table 1 ranks Sri Lanka’s overall infrastructure performance and the quality of key components of infrastructure compared with regional economies. Sri Lanka’s rank of 61 means its overall infrastructure performance falls well below other upper-middle-income economies, such as Malaysia, and some components, such as air connectivity and efficiency of seaport services, are on par with low-income countries, such as Pakistan.

Table 1: Quality of infrastructure, 2019

	Overall infrastructure rank	Quality of roads	Efficiency of train services	Efficiency of air transport services	Air connectivity	Efficiency of seaport services	Electricity supply quality
China	36	45	24	66	2	52	18
Malaysia	35	19	13	25	20	19	38
Thailand	71	55	75	48	9	73	31
Sri Lanka	61	76	49	72	59	68	39
Vietnam	77	103	54	103	22	83	62
Pakistan	105	67	47	93	41	70	99

Source: WEF, Global Competitiveness Report 2019.

Note: Rank out of 141. Quality of roads, efficiency of train services, efficiency of air transport services and seaport services are derived from an opinion survey; air connectivity represents the IATA airport connectivity indicator, which measures the degree of integration of a country within the global air transport network; electricity supply quality is measured using electric power transmission and distribution losses as a percentage of domestic supply.

⁴ World Economic Forum (2019), *The Global Competitiveness Report 2019*, Cologny/Geneva, http://www3.weforum.org/docs/WEF_TheGlobalCompetitivenessReport2019.pdf (accessed 3 Feb. 2020).

Table 2: Financial terms and expected economic benefits of major Chinese projects

Project Name	Loan/ Investment	Amount \$ million	Loan terms	Foreign lender/ Investor	Implementing agency	Contractor	Economic benefits
Southern Expressway (ongoing, started construction in 2011)	Loan (4)	1,545	Fixed Rate – 2%	EXIM	Road Development Authority	CCC	<ul style="list-style-type: none"> • 48% of total expressways. • Commute to Galle from Colombo has halved from 3 hours to 1.5 hours. • Better infrastructure has allowed the southern coast to develop as a tourist hotspot.
Outer Circular Highway Project (ongoing, started construction in 2014)	Loan (1)	494	Fixed Rate – 2%	EXIM	Road Development Authority	Metallurgical Corporation of China Ltd	<ul style="list-style-type: none"> • 5% of total expressways. • Easier commute to Colombo from suburbs.
Colombo Katunayake Expressway (completed in 2013, started construction in 2009)	Loan (1)	248	Fixed Rate – 6.3%	EXIM	Road Development Authority	China Metallurgical Group Corporation	<ul style="list-style-type: none"> • 15% of total expressways. • Reduced commuting time to airport from 2 to 1.5 hours from Central Colombo.
Hambantota International Airport project (completed in 2013, started construction in 2010)	Loan	190	Fixed Rate – 2%	EXIM	Airport & Aviation Lanka Limited	CHEC	<ul style="list-style-type: none"> • Emergency landings possible with 2nd airport. • Saved Sri Lanka \$1.5 M per flight, if diverted to Southern India during an emergency. • Increased national passenger capacity, reducing congestion at Colombo Airport.
Hambantota Port Development Project (completed, started construction in 2007)	Loan (3)	1,335.7	Fixed (2–6.5%) and Variable Rates	EXIM	Sri Lanka Ports Authority	CHEC	<ul style="list-style-type: none"> • Industrial zone will bring in more primary industries. • Diversified port operations through the addition of value-added services.
CICT Colombo Terminal (completed in 2014, started construction in 2011)	Investment	500	N/A	CMPH	Sri Lanka Ports Authority	CMPH	<ul style="list-style-type: none"> • Currently the only deep-water terminal in South Asia equipped with facilities to handle the largest vessels afloat. • CICT has helped the Port of Colombo to move up the Drewry's Port Connectivity Index to be ranked the 11th best connected port in the world in 2018.
Norocholai power station (completed in March 2011, started construction in 2006)	Loan (3)	1,346	Fixed Rate – 2%	EXIM	Ceylon Electricity Board	China Machinery Engineering Corporation	<ul style="list-style-type: none"> • Accounts for 31% of total installed capacity of CEB-owned power plants. • Accounts for 33% of Sri Lanka's total power generated in 2018.
Colombo Port City (ongoing, to be completed in 2042, started construction in 2014)	Investment	1,300	N/A	CHEC	N/A	CHEC	<ul style="list-style-type: none"> • Adding 1.5 million units of A-Grade office space (tripling total office space in Colombo). • Would improve Sri Lanka's ease of doing business rankings. • Likely to attract high tier financial services.
Lotus Tower (completed in September 2019, started construction in 2012)	Loan	88.6		EXIM	Telecommunications Regulatory Commission of Sri Lanka	China National Electronics Import & Export Corporation	<ul style="list-style-type: none"> • Improve telecommunications infrastructure. • Reduce the number of downtime incidences. • Provide leisure activities to public.

Source: Calculations based on data provided by the Central Bank of Sri Lanka, Department of External Resources, Ministry of Finance, Sri Lanka; Board of Investments, Sri Lanka, and various interviews with key persons.

Notes: EXIM: Export-Import Bank of China; CMPH: China Merchant Port Holdings; CHEC: China Harbour Engineering Company; CCC: China Communications Construction Company Limited.

Studies have attempted to quantify unmet infrastructure needs across South Asia and provide indicative estimates of current infrastructure gaps. In 2014, a World Bank report on infrastructure in South Asia conservatively estimated that Sri Lanka requires as much as \$36 billion (at current prices) to close its infrastructure gap. This works out at a staggering 40.5 per cent of Sri Lanka's 2018 GDP.

Taking into account existing Chinese investment commitments, Sri Lanka's present infrastructure financing requirement is estimated to be around \$23.9 billion.⁵ Chinese infrastructure investment alone is insufficient to close Sri Lanka's infrastructure gap. Cumulative Chinese infrastructure investment commitments, since 2006, amount to approximately 33 per cent of the estimated figure needed.⁶ Sri Lanka faces the difficult task of raising significant amounts of additional finance from other sources (international capital markets, general taxation and other donors) for its unmet infrastructure needs.

What are the expected economic benefits of Chinese investments?

One way to assess the expected economic benefits of Chinese infrastructure investments is to look at the effects of specific projects on Sri Lanka's infrastructure development. Table 2 provides details of major Chinese projects including financing, actors and expected economic benefits.

Roads and expressways are the largest subsector⁷ for Chinese investment in Sri Lanka. Since 2009, investment from China has built an estimated 116.1 km or 68 per cent of the length of all expressways in Sri Lanka.⁸ Three major expressway projects – the Southern Expressway, the Colombo–Katunayake Expressway, and the Colombo Outer Circular Highway – have benefited from this investment. These infrastructure projects have significantly contributed to improving national road connectivity, enhancing road safety and reducing journey times. These investments have the potential to help Sri Lanka attain the same quality of roads seen in other upper-middle-income economies like Malaysia.

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For example, the 126-km Southern Expressway, linking Colombo with the major cities of Galle and Matara, has opened up southern Sri Lanka, halved journey times from Colombo to Galle to 1.5 hours, and improved road safety.⁹ Four loans from the Export-Import Bank of China (EXIM Bank China) totalling \$1.6 billion between 2014 and 2017¹⁰ supplemented start-up loans that the project received in the early 2000s from the Asian Development Bank (ADB) and the Japan Bank

⁵ This figure is estimated by subtracting the \$12.13 billion of Chinese infrastructure investment commitments since 2006 in Figure 1, from the estimated infrastructure gap of \$36 billion from Andres, L., Biller, D. and Herrera Dappe, M. (2014), *Infrastructure Gap in South Asia: Infrastructure Needs, Prioritization and Financing*, Policy Research Paper, Washington, DC: World Bank, https://www.researchgate.net/profile/Matias_Herrera_Dappe2 (accessed 3 Feb. 2020).

⁶ Ibid.

⁷ Calculations based on data from Department of External Resources, Ministry of Finance (2019), 'Official Development Assistance Database', http://www.erd.gov.lk/index.php?option=com_content&view=article&id=89&Itemid=312&lang=en (accessed 1 Dec. 2019).

⁸ Road Development Authority, Sri Lanka (2020), 'National Highways', http://www.rda.gov.lk/source/rda_roads.htm (accessed 3 Feb. 2020).

⁹ ADB (2014), *Sri Lanka: Southern Transport Development Project*, <https://www.adb.org/sites/default/files/project-document/81845/26522-023-pcr.pdf#page=16> (accessed 25 Feb. 2020).

¹⁰ Calculations based on data from Department of External Resources, Ministry of Finance (2019), 'Official Development Assistance Database'.

for International Cooperation. China Harbour Engineering Company, China State Construction Engineering Corporation and China Aviation International Engineering Company constructed the Chinese-financed sections of the Southern Expressway.

Ports are the second-largest subsector for Chinese investment, for example building the fourth terminal at Colombo port and constructing the new Hambantota port in Southern Sri Lanka. Investments in port capacity, and the ability to handle containerized cargo from mega container ships, have enabled Sri Lanka to leverage its strategic geographical location in the Indian Ocean and become a regional trading hub. In 2018, about 79 per cent of Colombo port's throughput was for transshipment purposes in response to demand from a rapidly growing Indian market.¹¹

A major part of the success of the Colombo port is due to an initial Chinese investment of \$500 million in 2011 by China Merchant Port Holdings Company in the CICT. This is the only state of the art deep-water terminal in South Asia, which can handle ultra large container carriers (ULCC) or more than 20,000 twenty-foot-equivalent-unit (TEU) vessels. Commencement of CICT operations in 2014 was critical in Sri Lanka, consolidating its position in regional transshipment trade over the last few years. With the geographical coverage of these services and high frequency of mainline liner service connections, CICT has helped the Colombo port become the 11th best connected port in the world.¹²

Another key project was the transshipment port at Hambantota in the early 2000s, which was expected to become the country's second-largest port after Colombo port. It was financed by three fixed interest rate loans from EXIM Bank China amounting to \$1.4 billion.¹³ Two Chinese state-owned enterprises (SOEs), China Harbour Engineering and Sinohydro Corporation, constructed the port. However, the project took longer than expected to come on stream and incurred financial losses putting a strain on Sri Lanka's public finances. Some have seen this as an example of unprofitable infrastructure investment and China's so called 'debt-trap diplomacy'.¹⁴

To stem financial losses, in 2017, the coalition government of President Sirisena agreed to give Chinese SOEs a controlling interest in managing the port under a 99-year lease. In accordance with a risk-sharing agreement, Sri Lanka received \$1.12 billion, which was used to bolster the country's foreign exchange reserves.¹⁵ Furthermore, the management of the Hambantota port moved to a Chinese SOE, China Merchant Port Holdings Company Limited. This global port operator is not only developing Hambantota port and the adjacent industrial zone but also working to diversify the range of available port related services (e.g. ship repairing and bonded warehousing and distribution). Once Hambantota port becomes fully operational over the next few years, container traffic through Sri Lanka has the potential to double to some 16 million TEUs. The adjacent industrial zone is expected to attract new foreign investment and create jobs.

¹¹ Ministry of Ports and Shipping and Southern Development (2018), *Performance Report 2018*, Colombo: Ministry of Ports and Shipping and Southern Development, <https://www.parliament.lk/uploads/documents/paperspresented/performance-report-ministry-of-ports-shipping-2018.pdf> (accessed 3 Feb. 2020).

¹² *Sunday Observer*, Sri Lanka (2019), 'Colombo Port, 11th best connected in the World', 6 January 2019, <http://www.sundayobserver.lk/2019/01/06/business/%E2%80%98colombo-port-11th-best-connected-world%E2%80%99> (accessed 3 Feb. 2020).

¹³ Calculations based on data from Department of External Resources, Ministry of Finance (2019), 'Official Development Assistance Database'.

¹⁴ Thorne and Spevack explore the link between China's investment in the Hambantota port and geopolitical strategy. They argue that the terms of the 99-year lease on Hambantota port favour China, that the investment generated political influence, and that Chinese debt constricts Sri Lankan policy. Thorne, D. and Spevack, B. (2017), *Harbored Ambitions: How China's Port Investments are Strategically Reshaping the Indo-Pacific*, Washington, DC: Center for Advanced Defense Studies, <https://static1.squarespace.com/static/566ef8b4d8af107232d5358a/t/5ad5e20ef950b777a94b55c3/1523966489456/Harbored+Ambitions.pdf> (accessed 3 Feb. 2020).

¹⁵ *Reuters* (2018), 'Chinese firm pays \$584 million in Sri Lanka port debt-to-equity deal', 3 February 2020, <https://www.reuters.com/article/us-sri-lanka-china-ports/chinese-firm-pays-584-million-in-sri-lanka-port-debt-to-equity-deal-idUSKBN1JG2Z6> (accessed 3 Feb. 2020).

Non-renewable energy generation is the third-largest sector for Chinese investment in Sri Lanka. In the early 2000s, Sri Lanka suffered from unreliable electricity supply and periodic power cuts that hampered the economy.¹⁶ A temporary solution of commissioning 10 diesel power plants did little to alleviate the electricity supply problem and exacerbated the high dependence on imported diesel fuel and high electricity prices.

Eventually, the Norocholai power station in northwest Sri Lanka – also known as the Puttlam power plant – emerged as a longer-term solution to the country’s electricity supply problems. It was co-financed by three EXIM Bank China loans amounting to \$1.4 billion,¹⁷ with additional financing from the government of Sri Lanka. The China Machinery Engineering Corporation began construction on the project in 2007 and built it in three phases – each with a 300-megawatt capacity – over a seven-year period. The Norocholai power station is now the largest power station in the country and a significant contributor to the country’s electricity supply. The power plant made up 31.1 per cent of the total installed capacity of Ceylon Electricity Board-owned power plants and accounted for 33 per cent of total Sri Lankan power generation in 2018.¹⁸

Urban development in the form of the Port City Colombo project is the fourth subsector for Chinese investment. It is a new city built on 269 hectares of reclaimed land as an extension of Colombo’s central business district.

Along with water and sanitation, urban development in the form of the Port City Colombo project is the fourth subsector for Chinese investment. It is a new city built on 269 hectares of reclaimed land as an extension of Colombo’s central business district.¹⁹ An international financial centre lies at the heart of this project along with residential and retail developments. CHEC Port City Colombo (Pvt) Ltd, which is a wholly owned subsidiary of China Harbour Engineering Company (CHEC), whose parent company is China Communications Construction Company, is the main developer and has initially invested \$1.3 billion. The Port City is expected to be a game changer for modern service development in Sri Lanka, made up of financial, ICT and professional services along the lines of Dubai International Financial Centre and the Gujarat International Financial Tec-City. On completion in 2042, the development is expected to add 1.5 million units of A-grade office space to Colombo, tripling the current office space capacity.²⁰ Furthermore, assuming the Port City is 60 per cent operational, it will generate 122,000 jobs and bring in FDI close to half a billion dollars. Even higher numbers are predicted during the construction phase of the project.²¹

¹⁶ *The Island* (2018), ‘Power Sector in Shambles’, 2 April 2018, http://www.island.lk/index.php?page_cat=article-details&page=article-details&code_title=182541 (accessed 2 Feb. 2020).

¹⁷ Calculations based on data from Department of External Resources, Ministry of Finance (2019), ‘Official Development Assistance Database’.

¹⁸ Ceylon Electricity Board (2019), *Statistical Digest 2018*, Colombo: Ceylon Electricity Board, https://www.ceb.lk/front_img/img_reports/1567487133Statistical_Digest_2018.pdf (accessed 3 Feb. 2020).

¹⁹ Lakshman Kadirgamar Institute (forthcoming), *Port City SEZ: A Catalyst for Modern Services in Sri Lanka*, Colombo.

²⁰ Author interview with three separate Port City officials, who wished to remain anonymous, at Port City Colombo, 13 March 2019.

²¹ PwC (2020), *Economic Impact Assessment of Port City Colombo*, <https://www.pwc.com/lk/en/assets/document/2020/Port-City-Report.pdf> (accessed 16 Mar. 2020).

Assessing the political and economic costs of Chinese investment

Some aspects of Sri Lanka's experience of Chinese infrastructure investment are portrayed as a cautionary tale for other developing countries. Three negative aspects or economic costs associated with Chinese infrastructure investment in Sri Lanka are analysed below: 1) the Chinese debt trap; 2) a trade deficit with China; and, 3) limited domestic spillovers from Chinese investments.

Has Sri Lanka fallen into a Chinese debt trap?

One widely held interpretation of China's approach to Sri Lanka is that it uses commercial loans to advance its economic and geostrategic interests in the country.²² This view has been expressed by US Vice President Mike Pence, billionaire financier George Soros, the New York Times and think-tanks in Delhi and Washington DC.²³ Their argument is that the BRI has extended large commercial loans for infrastructure projects in Sri Lanka without the strict conditionality normally imposed by multilateral development banks. Consequently, projects that were not commercially viable, particularly the Hambantota port, sustained losses. As a result, Sri Lanka became entangled in a debt trap that resulted in the country conceding majority control in national assets like Hambantota port and made the country vulnerable to Chinese influence.

However, cross-country macroeconomic analyses of Sri Lanka's debt dynamics do not support this argument. Hurley et al. assessed the likelihood of debt problems in a sample of 68 countries that received BRI investment from China but did not include Sri Lanka in the eight countries they identified as being of particular concern.²⁴ Similarly, another study of debt sustainability in 25 countries in Asia with exposure to BRI projects reported that Sri Lanka is at low-to-medium risk of BRI-related debt problems.²⁵ Mongolia, Kyrgyz Republic, Tajikistan, Laos and the Maldives are all at higher risk.

The IMF's review of its extended fund facility in Sri Lanka reported that China has become an important provider of commercial loans to Sri Lanka for infrastructure projects and that these loans amounted to about \$5 billion (15 per cent of external debt) at the end of 2018.²⁶ Sri Lanka faces a general foreign debt problem, but this has little to do with Chinese loans.²⁷ Such macroeconomic

²² Pence, M. (2018), 'Vice President Mike Pence's Remarks on the Administration's Policy Towards China', Remarks, Hudson Institute, <https://www.hudson.org/events/1610-vice-president-mike-pence-s-remarks-on-the-administration-s-policy-towards-china102018> (accessed 3 Feb. 2020); Soros, G. (2018), 'Remarks delivered at the World Economic Forum', <https://www.georgesoros.com/2019/01/24/remarks-delivered-at-the-world-economic-forum-2/> (accessed 3 Feb. 2020).

²³ Chellaney, B. (2017), 'China's Debt Trap Diplomacy', Project Syndicate, 23 January 2017, <https://www.project-syndicate.org/commentary/china-one-belt-one-road-loans-debt-by-brahma-chellaney-2017-01?barrier=accesspaylog> (accessed 3 Feb. 2020); Smith, J. (2019), 'Sri Lanka: A Test Case for the Free and Open Indo-Pacific Strategy', Heritage Foundation, 14 March 2019, <https://www.heritage.org/asia/report/sri-lanka-test-case-the-free-and-open-indo-pacific-strategy> (accessed 3 Feb. 2020); Mclyntre, J. (2018), 'Game of Loans: How China uses 'debt-trap diplomacy' to extend its military reach', Washington Examiner, 17 April 2018, <https://www.washingtonexaminer.com/policy/defense-national-security/how-china-uses-debt-trap-diplomacy-to-extend-its-military-reach> (accessed 3 Feb. 2020).

²⁴ The vulnerable countries are Djibouti, the Maldives, Laos, Montenegro, Mongolia, Tajikistan, Kyrgyz Republic and Pakistan. See Hurley, J., Morris, S. and Portelance, G. (2018), *Examining the Debt Implications of the Belt and Road Initiative from a Policy Perspective*, Washington, DC: Centre for Global Development, <https://www.cgdev.org/publication/examining-debt-implications-belt-and-road-initiative-a-policy-perspective> (accessed 3 Feb. 2020).

²⁵ Wignaraja, G., Tyson, J., Prizzon A. and Willem te Velde, D. (2018), *Asia in 2025*, Report, London: Overseas Development Institute, <https://www.odi.org/publications/11202-asia-2025-development-prospects-and-challenges-middle-income-countries> (accessed 5 Feb. 2020).

²⁶ International Monetary Fund, Asia and Pacific Dept. (2019), *Sri Lanka: Fifth Review Under the Extended Arrangement Under the Extended Fund Facility*, Washington, DC: IMF, <https://www.imf.org/en/Publications/CR/Issues/2019/05/15/Sri-Lanka-Fifth-Review-Under-the-Extended-Arrangement-Under-the-Extended-Fund-Facility-46900> (accessed 5 Feb. 2020).

²⁷ Weeakoon, D. and Jayasuriya, S. (2019), 'Sri Lanka's debt problem isn't made in China', East Asia Forum, <https://www.eastasiaforum.org/2019/02/28/sri-lankas-debt-problem-isnt-made-in-china/> (accessed 16 Mar. 2020).

analyses may not be regarded as conclusive as they only provide estimates of Sri Lanka's debt position and China's role in it. Furthermore, these studies make little mention of the critical issue of the debt sustainability of Chinese loans.

Based on data from the Ministry of Finance and the Central Bank of Sri Lanka, Table 3 provides information on Sri Lanka's total external public debt by holder and the ratio of debt service to exports. The data on Sri Lanka's total external debt and debt sustainability suggests that Sri Lanka may be at risk from a general external debt problem. In 2018, Sri Lanka's total external public debt rose to \$34.7 billion and its debt service ratio increased to 15 per cent.

Table 3: Sri Lanka's external public debt and debt service

	2012	2015	2018
Total external public debt (a) – \$ billion	23.7	28.6	34.7
<i>Of which is held by:</i>			
China (b)	2.2	4.8	5.0
Japan	4.3	3.4	3.4
Other bilateral lenders (c)	3.3	2.3	2.2
Multilateral lenders (d)	6.6	7.3	7.9
Financial markets	7.0	10.8	16.2
Other (e)	0.3	0.1	0.1
External debt service to exports of goods & services (f)	12.3%	12.0%	15.0%
<i>Of which is held by:</i>			
China	0.8%	2.3%	2.5%
Japan	2.5%	1.3%	1.2%
Other bilateral lenders	1.7%	1.8%	2.5%
Multilateral lenders (World Bank, ADB etc.)	2.0%	1.9%	2.3%
Financial markets (g)	5.2%	4.8%	6.6%

Source: Central Bank of Sri Lanka & Department of External Resources, Ministry of Finance Sri Lanka.

a) Total external public debt is calculated as external debt of the central government plus external debt of SOEs and public corporations.

b) Includes central government debt held by the Chinese government, China Development Bank, and the EXIM Bank China, as well as Chinese loans to SOEs.

c) Comprises of other external debt of SOEs for which the ownership is not published.

d) Bilateral lenders include India, US, Germany etc.

e) Multilateral lenders include World Bank, ADB etc.

f) Does not include debt service of foreign loans to SOEs.

g) Financial markets include: International sovereign bonds and foreign currency term financing facility.

The value of Sri Lanka's external public debt to China doubled from \$2.2 billion to \$5 billion between 2012 and 2018 with a significant spike in debt occurring between 2012 and 2014 (see Table 3). As a percentage of GDP, Sri Lanka's external debt to China rose from 3.2 per cent to 5.6 per cent between 2012 and 2018.²⁸ However, Sri Lanka owes less to China than it does to other foreign creditors. In 2018, external public debt owed to financial markets (e.g. holders of international bonds issued in Sri Lanka) accounted for as much as 18.2 per cent of Sri Lanka's GDP, while the amount owed to multilateral lenders stood at 8.9 per cent and bilateral lenders accounted for 6.3 per cent of external public debt. This compares with 2012 figures of 10.2 per cent owed to

²⁸ Calculations based on data from Central Bank of Sri Lanka (2018), *Annual Report 2018*, Colombo, https://www.cbsl.gov.lk/sites/default/files/cbslweb_documents/publications/annual_report/2018/en/14_Appendix.pdf (accessed 1 Dec. 2019).

financial markets, 9.7 per cent to multilateral lenders and 11.1 per cent to bilateral lenders.²⁹ This is indicative of a shift in Sri Lanka's foreign financing and debt dynamics during the transition to upper-middle-income status. A higher per capita income has meant that the country is graduating from concessionary aid towards more reliance on bilateral commercial loans and financial markets.

Debt sustainability – the ability to service external debt (principal plus interest) – is perhaps more indicative of a country's macroeconomic well-being than its level of total external debt. This is usually presented as a ratio to export earnings. From a low base, the cost of Sri Lanka's external public debt service to China quadrupled from \$104 million to \$498 million between 2012 and 2018.³⁰ However, Sri Lanka's ratio of external debt service to China to export earnings only saw a modest rise from 0.8 per cent to 2.5 per cent over the same period (see Table 3). Sri Lanka's burden of servicing debt to financial markets and other lenders is greater than that to China. For instance, in 2018, Sri Lanka's ratio of external debt service to financial markets to export earnings was 6.6 per cent and to bilateral lenders was 3.7 per cent of exports. Meanwhile, debt service to export ratios to multilateral lenders (2.3 per cent) was on par with the debt service ratio to China.

Have Chinese investments increased Sri Lanka's trade deficit with China?

Chinese infrastructure projects in Sri Lanka have relied heavily on imported capital goods and intermediate goods from China. For instance, the Southern Expressway was built using significant imports of Chinese road construction equipment and road construction materials.³¹ This reflects several factors including (i) established long-term buyer–seller relationships between Chinese SOE contractors in Sri Lanka and SOE suppliers in China, (ii) heavy state subsidies to highly protected SOE suppliers and private companies in China and hence artificially low prices for exports, and (iii) the lack of a capital goods industry in Sri Lanka.

The data show that Sri Lanka's imports of capital goods and intermediates from China have surged since 2006, linked to an increase in Chinese infrastructure investment.³² Before the announcement of the BRI, Sri Lanka's capital imports from China accounted for around 17 per cent of Sri Lanka's total capital goods imports in 2006–12, which rose to 27 per cent in 2013–17.³³ Meanwhile, Sri Lanka's intermediate goods imports from China rose from 58 per cent of the country's total intermediate goods imports to 62 per cent³⁴ over the same period. The import surge destined for Chinese infrastructure projects in Sri Lanka, coupled with a small base of Sri Lankan exports to China, translated into a growing trade deficit between the two countries. Sri Lanka's overall trade deficit with China (as a share of Sri Lanka's GDP) rose from -2.6 per cent in 2006–12 to -4.3 per cent in 2013–19.³⁵

²⁹ Ibid.

³⁰ Central Bank of Sri Lanka (2018), *Annual Report 2018*.

³¹ Chinese imports of road construction equipment included motor graders, road roller machines, asphalt mixing plants, forklift trucks, crawlers/excavators, rammers, truck cranes and wheel loaders. Meanwhile Chinese imports of road construction materials included bituminous materials, soil, cement and structural steel.

³² Calculations based on data from UN Comtrade, measured using BEC definitions. United Nations (2019), 'UN Comtrade Database', <https://comtrade.un.org/> (accessed 3 Feb. 2020).

³³ Calculations based on data from International Trade Centre (2019), 'Trade Map Database', <https://www.trademap.org/Index.aspx> (accessed 3 Feb. 2020).

³⁴ Ibid.

³⁵ Ibid.

Are there domestic spillovers from Chinese investment?

FDI is regarded as a crucial vehicle for economic development particularly for economies in the process of industrialization like Sri Lanka. Among other benefits, FDI tends to result in a diffusion of technology and management practices to domestic firms, which improves their productivity and competitiveness. Studies often distinguish between direct spillover effects of FDI (specific firm-to-firm knowledge transfers) and more indirect spillover effects from FDI (increased FDI presence, productivity improvements and industrialization).³⁶ However, project-level data gaps make it more challenging to analyse direct spillover effects.

The available data suggest that there were limited indirect domestic spillovers in terms of sectoral shifts, exports and employment from Chinese infrastructure investment since 2009. Information on sectoral shifts show that Chinese infrastructure investment has dominated Chinese FDI into Sri Lanka since 2009, accounting for 88.7 per cent in 2009–12 and rising to 99.4 per cent in 2017–18.³⁷ This occurred at the expense of Chinese FDI into manufacturing and services, which saw significant declines over the same period. Not surprisingly perhaps with low-level FDI support, Chinese firms in manufacturing and services have made little contribution to either exports or employment in Sri Lanka. They accounted for less than 1 per cent of the exports of all firms that work with the Board of Investment, Sri Lanka's investment promotion agency, in 2009–18 and about 1 per cent of employment of those firms in the same period.³⁸

Conclusion

While Sri Lanka became an upper-middle-income economy in 2019, its overall infrastructure performance remains well below the expectations for similar economies. The cumulative value of Chinese infrastructure investment into Sri Lanka, which amounted to \$12.1 billion between 2006 and July 2019, was insufficient to close Sri Lanka's huge infrastructure investment gap. The expected economic benefits to Sri Lanka from Chinese investment varies across sectors and projects with some sectors and projects generating greater economic benefits than others. While Sri Lanka is often portrayed as having been engulfed by a Chinese debt trap as a result of public investment finance, the evidence suggests that Sri Lanka has a general debt problem rather than a specific Chinese debt problem. Other challenges include a growing trade deficit with China and limited domestic spillovers from Chinese investment. The economic analysis in this chapter suggests that Sri Lanka should put in place more effective foreign debt management strategies, implement a strong investment promotion and export push towards the Chinese market and encourage greater domestic linkages from Chinese projects.

³⁶ Rand, J. (2015), 'Understanding FDI spillover mechanisms', Learning to Compete Working Paper, Washington, DC: The Brookings Institution, <https://www.brookings.edu/blog/africa-in-focus/2015/11/19/understanding-fdi-spillover-mechanisms/> (accessed 5 Feb. 2020).

³⁷ Board of Investment Sri Lanka (2019), 'Foreign Direct Investment Database', unpublished.

³⁸ Ibid.

2. Labour and the Environment

Implications for labour

Current trends in Chinese labour in Sri Lanka

Sri Lanka lacks a publicly available database on inbound migration and has limited ability to track illegal migrants due to the absence of a central data gathering system among key government agencies. There are roughly 7,500 Chinese migrant workers in Sri Lanka at present.³⁹ In recent years, the number of Chinese workers has risen, albeit from a low base. According to Sri Lanka's Department of Immigration and Emigration (Immigration Department), the number of residence visas issued to Chinese nationals rose from 4,134 in 2013 to 6,504 in 2018.⁴⁰ While local workers are recruited, Chinese construction firms tend to bring labour over from China to work on infrastructure projects in Sri Lanka.⁴¹ The rise in Chinese workers reflects the increasing number of BRI projects and private projects in Sri Lanka.⁴² Yet the absolute number of Chinese workers nevertheless remains quite small. It is estimated that Chinese workers only account for roughly 0.1 per cent of Sri Lanka's labour force in 2019.⁴³

The apparent growth in Chinese workers has also been associated with concerns of illegal migration. In 2017, it was estimated that Sri Lanka had close to 200,000 illegal migrant workers,⁴⁴ which is equivalent to about 2.5 per cent of Sri Lanka's workforce.⁴⁵ However, contrary to perception,⁴⁶ it appears that only a small proportion of illegal workers are from China. An investigation in late 2019 indicated that of 7,900 foreigners who overstayed their visas in Sri Lanka, 21 per cent were Indian, 12 per cent were Pakistani and 9 per cent were Chinese.⁴⁷ A recent immigration raid reflected the same proportions, where out of the 136 nationals arrested, only four were Chinese.⁴⁸ As such, the risk of illegal migrants from China is minimal in Sri Lanka.

³⁹ Calculation made using data on the number of visas issued by the Immigration Department and an estimate of illegal Chinese migrants from a news article. Department of Immigration Sri Lanka (2019), 'Database on Chinese Resident Visa Holders', unpublished; Kamalendran, C. (2019), 'Plan to deport more than 8,000 visa overstayers', *The Sunday Times, Sri Lanka*, 23 June 2019, <http://www.sundaytimes.lk/190623/news/plan-to-deport-more-than-8000-visa-overstayers-355098.html> (accessed 3 Feb. 2020). A similar figure was verified by the Chinese Embassy in Sri Lanka. There may be slightly higher unofficial figures.

⁴⁰ Department of Immigration (2019), 'Database on Chinese Resident Visa Holders'.

⁴¹ Abi-Habib, M. (2018), 'How China Got Sri Lanka to Cough Up a Port', *New York Times*, 25 June 2018, <https://www.nytimes.com/2018/06/25/world/asia/china-sri-lanka-port.html> (accessed 3 Feb. 2020).

⁴² Projects that use Chinese workers include ODEL Mall, Havelock City Commercial Development and Tri-Zen Residencies.

⁴³ Department of Census and Statistics Sri Lanka (2019), *Sri Lanka Labour Force Survey, Quarterly Report 2019*, Colombo, <http://203.94.94.89/mainsite/LabourForce/StaticInformation/Bulletins/2ndQuarter2019> (accessed 3 Feb. 2020).

⁴⁴ Andre, M. (2017), 'Over 200,000 Illegal Migrant Workers in Sri Lanka now 10,000 Visas Issued Per Year to Import Labour - Former Central Banker', *Ceylon Today*, 11 October 2017, http://www.ips.lk/wp-content/uploads/2017/10/CT_11Oct_SOE-Launch_Over-200000-illegal-migrant-workers.pdf (accessed 3 Feb. 2020).

⁴⁵ Calculated using Department of Census and Statistics, Sri Lanka (2017), *Sri Lanka Labour Force Survey, Annual Report 2017*, Colombo, http://www.statistics.gov.lk/samplesurvey/LFS_Annual%20Report_2017_version2.pdf (accessed 3 Feb. 2020).

⁴⁶ Wang, Y. (2019), 'See, They Are So Happy with Our Generosity!', *Human Rights Watch*, 18 July 2019, <https://www.hrw.org/news/2019/07/18/see-they-are-so-happy-our-generosity> (accessed 3 Feb. 2020); Frayer, L. (2019), 'In Sri Lanka, China's Building Spree is Raising Questions About Sovereignty', 13 December 2019, https://www.npr.org/2019/12/13/784084567/in-sri-lanka-chinas-building-spree-is-raising-questions-about-sovereignty?fbclid=IwAR2RAsmOuvIG5M6am2YlfWR6VLGZczbyYSvq4bPrmbJ4ox9K08fm51S5F_0 (accessed 5 Feb. 2020).

⁴⁷ Kamalendran (2019), 'Plan to deport more than 8,000 visa overstayers'.

⁴⁸ *Ada Derana* (2020), '136 foreign nationals arrested over visa violations', 6 January 2020, <http://www.adaderana.lk/news/60056/136-foreign-nationals-arrested-over-visa-violations> (accessed 3 Feb. 2020).

Most BRI projects in Sri Lanka are large-scale infrastructure developments that require a sizable labour force and diverse skill sets.⁴⁹ While the demand for skilled and unskilled labour varies by the nature and stage of the project, the perception that BRI projects are mainly staffed by Chinese workers may be unfounded. For example, the Colombo Port City has 1,637 workers, including employees from both the Chinese parent company and the local engineering, procurement and construction company. Of this number, 22.4 per cent are Chinese migrant workers.⁵⁰ CICT, which operates a terminal of the Colombo port, has 1,350 employees, of which less than 2 per cent are Chinese.⁵¹ Similarly, Hambantota port now employs about 900 workers, of which only 3.3 per cent are Chinese.⁵²

Potential benefits of Chinese labour

A main benefit of Chinese labour is that it relieves local labour shortages, especially in the construction sector. The industry, valued at about \$8 billion,⁵³ currently faces a deepening labour shortage due to two main factors. First, local workers are increasingly migrating abroad, seeking better pay and livelihoods; and second, Sri Lankans who do not venture abroad see limited appeal in the local construction industry and unskilled labour market.⁵⁴

The local labour shortages have been exacerbated by the rapid increase in domestic urban development projects. The 2018 report on *Migration Governance in Sri Lanka*⁵⁵ compiled by the UN International Organization for Migration (IOM) estimates that Sri Lanka needs 400,000 workers to meet the shortfall in the construction sector. This gap has not only been met by workers from China, but also by those from neighbouring countries like India and Nepal,⁵⁶ allowing construction companies to keep their cost component low.⁵⁷

Skill and knowledge transfers are another benefit of foreign migration to Sri Lanka. The Hambantota International Port Group (HIPG), for example, has a strong localization policy, with 51 per cent of its employees from the Southern Province.⁵⁸ Local workers have the opportunity to work with foreign workers, enabling the absorption of skills such as operating advanced equipment. The same company also conducts structured training sessions,⁵⁹ which are hosted by senior management to introduce local workers to modern skills and practices in the port sector. This allows local workers to improve their skill sets and employability.

⁴⁹ Author interviews with three Port City officials, who wished to remain anonymous, at Port City Colombo, 13 March 2019.

⁵⁰ Ibid.

⁵¹ Mudalige, D. (2019), 'China, Sri Lanka tie-up to revive agri productivity – Ambassador', *Daily News*, Sri Lanka, 30 October 2019, <http://www.dailynews.lk/2019/10/30/local/201403/china-sri-lanka-tie-revive-agri-productivity-ambassador> (accessed 3 Feb. 2020).

⁵² Author interviews with three Hambantota International Port Group officials, who wished to remain anonymous, Hambantota (2019).

⁵³ *Lanka Business Online* (2018), 'Construction sector challenged by continued labour shortage: report', 16 February 2018, <https://www.lankabusinessonline.com/construction-sector-challenged-by-continued-labour-shortage-report/> (accessed 3 Feb. 2020).

⁵⁴ Author interview with a representative from the National Human Resources Development Council (NHRDC), who wished to remain anonymous, Colombo, 19 June 2019; Verité Research (2019), *Youth Labour Market Assessment*, Colombo: Verité Research, <https://www.veriteresearch.org/wp-content/uploads/2019/02/Youth-Labour-Market-Assessment-26.12.2018.pdf> (accessed 3 Feb. 2020).

⁵⁵ International Organization on Migration (2018), *Sri Lanka Country Report 2018: Migration Governance in Sri Lanka*, Colombo, https://srilanka.iom.int/sites/srilanka/files/documents/MGI%20Country%20Report_2018%20New.pdf (accessed 3 Feb. 2020).

⁵⁶ Perera, Q. (2018), 'Foreign construction workers outshine local counterparts', *The Sunday Times, Sri Lanka*, 25 February 2018, <http://www.sundaytimes.lk/180225/business-times/foreign-construction-workers-outshine-local-counterparts-283024.html> (accessed 3 Feb. 2020).

⁵⁷ Ibid.

⁵⁸ Hambantota International Port Group (2019), *Introduction to HIPG*, PowerPoint Presentation, Hambantota International Port Group, Hambantota: Hambantota International Port Group.

⁵⁹ Ibid.

Other project companies, including CICT, organize and support formal training initiatives by partnering with local institutions. For example, in 2016, CICT closely worked with the National Apprentice and Industrial Training Authority (NAITA) to train quay crane operators.⁶⁰ Other initiatives include sending local workers abroad for workshops and other training.⁶¹

Drawbacks and concerns

Given the significant scale and demand for labour, BRI projects can provide new job opportunities to local workers. However, most local workers lack the necessary skills to benefit from the types of job created. According to a 2015 report by the International Labour Organization (ILO) on Sri Lanka's industrial skills gap,⁶² the most recent estimates indicate that only 11 per cent of local construction⁶³ workers have undertaken formal technical and vocational education and training (TVET). As a result, foreign contractors tend to find it difficult to recruit suitable workers.

BRI projects can provide new job opportunities to local workers. However, most local workers lack the necessary skills to benefit from the types of job created.

To encourage high-skilled migrant labour and skill transfer, it would be beneficial to streamline the work permit process and introduce relevant (e.g. TVET) schemes. Attracting high-skilled workers, such as at the management level, could be done through a digital fast-track service for specific visa categories. Sri Lanka should also look to increase skill transfer via new national legislation and incentives for firms investing in these practices. For instance, Sri Lanka could adopt a system akin to that followed in South Africa⁶⁴ where a skill transfer plan must be produced for each foreign employee.

Concerns have also been expressed about deficiencies in the regulatory framework governing foreign workers.⁶⁵ While Sri Lanka has a national strategy⁶⁶ and laws for outward migration,⁶⁷ the UN IOM 2018 country report notes that it lacks adequate laws on inward migration. Existing frameworks such as the 2008 National Labour Migration Policy⁶⁸ focus on protecting and empowering outgoing migrant workers. Other challenges include ensuring that Sri Lanka is not overly reliant on workers from China or any other country in a particular sector, and that foreign workers are protected and have redress against discriminatory practices. The outbreak of the COVID-19 virus underscored these issues. Early evidence indicates shortages of Chinese construction workers in Sri Lanka after the lunar New Year, and that Chinese workers in Sri Lanka suffered from racial discrimination.⁶⁹

⁶⁰ *DailyFT* (2016), 'CICT partners NAITA to offer training for Quay Crane Operators', 7 September 2016, <http://www.ft.lk/article/566372/CICT-partners-NAITA-to-offer-training-for-Quay-Crane-Operator> (accessed 3 Feb. 2020).

⁶¹ Author interview with three Hambantota International Port Group officials, who wished to remain anonymous, Hambantota (2019).

⁶² International Labour Organization (2015), *The Skills Gap in Four Industrial Sectors in Sri Lanka*, Colombo, https://www.ilo.org/wcmsp5/groups/public/---asia/---ro-bangkok/---ilo-colombo/documents/publication/wcms_359346.pdf (accessed 13 Jan. 2020).

⁶³ *Ibid.*

⁶⁴ Ernst and Young (2015), 'South Africa requires employers to produce a skill transfer plan for all foreign employees', <https://www.ey.com/gl/en/services/people-advisory-services/hc-alert--south-africa-requires-employers-to-produce-a-skill-transfer-plan-for-all-foreign-employees> (accessed 3 Feb. 2020).

⁶⁵ Author interview with a representative from the NHRDC, who wished to remain anonymous, Colombo, 19 June 2019.

⁶⁶ Sri Lanka Bureau of Foreign Employment (2017), *Corporate Plan 2017-202*, Colombo, <http://www.slbfe.lk/file.php?FID=386> (accessed 13 Jan. 2020).

⁶⁷ Sri Lanka Bureau of Foreign Employment (2011), 'Sri Lanka Bureau of Foreign Employment Act', Colombo, <http://migrantinfo.lk/wp-content/uploads/2017/09/SLBFE-Act-3.pdf> (accessed 5 Feb. 2020).

⁶⁸ Ministry for Foreign Employment Promotion and Welfare (2008), *National Labour Migration Policy for Sri Lanka*, Colombo, <https://www.ilo.org/dyn/migpractice/docs/268/Policy.pdf> (accessed 13 Jan. 2020).

⁶⁹ Jayasinghe, C. (2020), 'Coronavirus stalls construction projects in Sri Lanka', *Economy Next*, 11 February 2020, <https://economynext.com/coronavirus-stalls-construction-projects-in-sri-lanka-49226/> (accessed 20 Feb. 2020).

Underpinning these issues is a need for regularly collated information on foreign labour in Sri Lanka and more information-sharing and coordination among the regulatory agencies. For instance, Sri Lanka does not issue an occupational shortage list,⁷⁰ like those released by the UK and Canada,⁷¹ to maximize the benefits of inward migration. Without any firm criteria for selection, or monitoring mechanisms of inward migrant workers, Sri Lanka may not be recruiting the labour it needs most.

The Sri Lankan government is taking some initial measures to address the above concerns, which should be accelerated. The National Human Resource Development Council (NHRDC), which is under the purview of the Ministry of National Policy and Planning, is presently working on improving policies and mechanisms to regulate inward migration. There should be better coordination under a framework agreement that operates across all the relevant agencies, including the Immigration Department and the Department of Labour. The agreement should also incorporate a centralized mechanism to collect data across these agencies, which can continually feed into the policymaking process led by the NHRDC.

Implications for the environment

Environmental successes and progress

Case studies of the CICT terminal of the Colombo port, and for the Colombo Port City, show that recent Chinese investment in Sri Lanka has made progress on environmental issues.

The CICT terminal of the Colombo port, for example, explicitly prioritizes green technology,⁷² having switched to using electric cranes, and pledging to reduce overall carbon dioxide emission levels by 45 per cent and diesel consumption levels by 95 per cent.⁷³ The crane engines emit zero carbon dioxide and minimal greenhouse gases.⁷⁴ Over 80 per cent of the electricity used in the operations of the CICT terminal is reportedly generated using solar technology. The fact that the CICT terminal is the most profitable of the four operational terminals of the Colombo port, contributing over 70 per cent of the port's cargo volume,⁷⁵ demonstrates that there is no need to compromise commercial success when reducing environmental damage.

The Colombo Port City represents another development guided by international green standards.⁷⁶ The project is guided by a sustainability master plan,⁷⁷ which aims to ensure the overall design for construction and operations is in line with international best practices and benchmarks, including climate change adaption and more specifically LEED,⁷⁸ BREEAM⁷⁹ and Green Mark standards,⁸⁰ while also ensuring that they meet green certifications from the Sri Lankan Green Building Council.

⁷⁰ International Organization on Migration (2018), *Sri Lanka Country Report 2018*.

⁷¹ GOV.UK. (2020), 'Immigration Rules Appendix K: shortage occupation list', <https://www.gov.uk/guidance/immigration-rules/immigration-rules-appendix-k-shortage-occupation-list> (accessed 3 Feb. 2020).

⁷² Colombo International Container Terminals (2018), 'CICT invests over \$10 m towards green infrastructure at Colombo Port', <http://www.cict.lk/read/news/3> (accessed 3 Feb. 2020).

⁷³ Ibid.

⁷⁴ Ibid.

⁷⁵ *Lanka Business Online* (2018), 'CICT ends 2018 with 2.65mn TEUs, 38-pct of Colombo Port's volume', 31 December 2018, <https://www.lankabusinessonline.com/cict-ends-2018-with-2-65mn-teus-38-pct-of-colombo-ports-volume/> (accessed 3 Feb. 2020).

⁷⁶ International Institute for Sustainable Development (2001), *Global Green Standards*, Manitoba, <https://www.iisd.org/library/global-green-standards> (accessed 3 Feb. 2020).

⁷⁷ CHEC Port City Colombo (Pvt) Ltd (2017), 'Sustainability', <http://www.portcitycolombo.lk/sustainability/> (accessed 3 Feb. 2020).

⁷⁸ U.S. Green Building Council (2020), 'LEED v4.1', <https://www.usgbc.org/leed/v41> (accessed 3 Feb. 2020).

⁷⁹ Building Research Establishment (2020), 'What is BREEAM?', <https://www.breeam.com/> (accessed 13 Jan. 2020).

⁸⁰ Building & Construction Authority (2019), 'About BCA Green Mark Scheme', https://www.bca.gov.sg/greenmark/green_mark_buildings.html (accessed 13 Jan. 2020).

The project has promised independently validated compliance with all sustainability requirements of relevant authorities.⁸¹ An early such requirement was an ISO 9001:2015 certification for the quality management system (QMS),⁸² which the project recently obtained. Continuing with such best practices in line with international standards would serve to reduce the risk of environmental damage from major infrastructure development projects in Sri Lanka.

Environmental challenges in Sri Lanka

Notwithstanding the positives described above, Chinese investment projects in Sri Lanka have faced several environmental challenges in their design, implementation and operation. Earlier infrastructure projects have caused significant pollution and affected the ecological landscape and biodiversity of Sri Lanka. The Norocholai power station, for instance, has been criticized for flouting domestic environmental norms; while other projects like the Hambantota port have met environmental challenges during the construction phase,⁸³ or been criticized for not studying all environmental risks that come with infrastructure development. For example, it was reported that studies of the Hambantota port failed to detect a rock on the seabed that impeded the access of ships to the harbour.⁸⁴ The position and size of the rock reportedly caused major delays and additional expenses of \$40 million to remove.⁸⁵

Pollution and challenges to ecological landscapes

The construction and ongoing operations of the Norocholai power station have led to significant carbon emissions.⁸⁶ Civil society organizations in Sri Lanka have noted their impact on the livelihoods and health of nearby residents.⁸⁷ Fine ash particles emitted from the Norocholai power station, which are linked to chronic illness in humans and animals, have been found in Colombo, 145 km away.⁸⁸ The Norocholai power station is located in the Kalpitiya peninsula, an area home to a variety of marine life including dolphins and whales. It is also 50 km from Wilpattu National Park, the country's largest national park, which is home to Sri Lankan elephants and leopards, among other diverse fauna and flora.

⁸¹ Central Engineering Consultancy Bureau (CECB) (2015), 'Proposed Colombo Port City Development Project, Colombo Sri Lanka', Colombo, <https://ejustice.lk/pdf/eia/port-city/Final%20SEIA%20%20Report-English%20opened%20for%20public%20comments%20new.pdf> (accessed 13 Jan. 2020).

⁸² *DailyFT* (2019), 'Port City gets ISO 9001:2015 certification', 28 February 2019, <http://www.ft.lk/front-page/Port-City-gets-ISO-9001-2015-certification/44-673691> (accessed 13 Jan. 2020).

⁸³ BBC News (2011), 'Rock on seabed delays Sri Lanka's Hambantota port', 5 August 2011, <https://www.bbc.com/news/world-south-asia-14418114> (accessed 13 Jan. 2020).

⁸⁴ *DailyFT* (2016), 'Troubled waters', 15 December 2016, <http://www.ft.lk/columns/troubled-waters-2/4-585555> (accessed 13 Jan. 2020).

⁸⁵ Aneez, S. (2011), 'Sri Lanka seeks \$40 mln Chinese loan for port rock removal', *Reuters*, 23 August 2011, <https://www.reuters.com/article/srilanka-port/sri-lanka-seeks-40-mln-chinese-loan-for-port-rock-removal-idUSL4E7JN1SY20110823> (accessed 5 Feb. 2020).

⁸⁶ *The Sunday Times, Sri Lanka* (2019), 'Tests show Lakvijaya plant spews out dust 16 times over the limit', 2 June 2019, <http://www.sundaytimes.lk/190602/news/tests-show-lakvijaya-plant-spews-out-dust-16-times-over-the-limit-352005.html> (accessed 13 Jan. 2020).

⁸⁷ U.S. National Library of Medicine (2017), 'Power Plants', <https://toxtown.nlm.nih.gov/sources-of-exposure/power-plants> (accessed 13 Jan. 2020).

⁸⁸ *The Sunday Times, Sri Lanka* (2019), 'Norocholai ash contaminates Lanka's western atmosphere', 10 March 2019, <http://www.sundaytimes.lk/190310/sunday-times-2/norocholai-ash-contaminates-lankas-western-atmosphere-339797.html> (accessed 13 Jan. 2020).

Port activities release harmful pollutants including carbon and non-carbon varieties, greenhouse gases, smog and soot-causing nitrogen oxides.⁸⁹ Operational activities from the Hambantota port including the arrival of ships, the loading and unloading of cargo, and land-based transport are likely to release air pollutants that significantly elevate environmental risks and challenges, given the port's ecologically sensitive surroundings.

It has been reported that animal habitats were affected by the dredging of 40,000 m³ of sand from the Karagan Lewaya Lagoon for the Hambantota port's construction,⁹⁰ and that this dredging destroyed the ecology of the lagoon and surrounding habitats.⁹¹ The Bundala National Park, which is located less than 40 km from the Hambantota port, spans 4,000 hectares⁹² and is a habitat for migratory birds and elephants. The local marine environment is also at risk from the release of chemical and physical waste, oil pollution, ballast water and other discharges from cargo ships.

Similarly, the land reclamation of 269 hectares for the Colombo Port City and its subsequent development plans have also raised environmental issues, including disruptions to marine habitats⁹³ and resulting economic challenges to the local fishing industry, with a reported 20 per cent decrease in fish catches.⁹⁴ An environmental advocacy organization in Sri Lanka has contended that the Port City will have a 'severe and highly detrimental' effect on the surrounding coastline, fish stocks and marine biodiversity.⁹⁵ However, the second and latest environmental impact assessment (EIA) on the Port City, released in 2017, noted that sand dredging would not cause any erosion to the coastline.⁹⁶ To curb these adverse environmental and ecological effects, Sri Lanka could introduce incentives for projects that meet criteria on green, innovative or energy-saving technology. Domestic standards for foreign investment-led infrastructure projects should be raised to match international standards and ensure that Sustainable Development Goals (SDGs) are taken into account. Sri Lanka should look to innovative partners in green technology and green financing systems and seek projects and investors that prioritize environmental protection in their investment. A long-term investment strategy for reducing risks of environmental damage would be beneficial.

Challenges with domestic legislation

Sri Lanka has wide-ranging environmental laws.⁹⁷ The National Environmental Protection Law of 1980 covers standards on pollution, waste disposal and management, and other environmental concerns.⁹⁸ It ensures that an environmental protection licence must be issued for certain industrial

⁸⁹ Bailey, D. and Solomon, G. (2004), 'Pollution prevention at ports: clearing the air', *Environmental Impact Assessment Review*, 24(7–8): pp. 749–774, doi: 10.1016/j.eiar.2004.06.005 (accessed 5 Feb. 2020).

⁹⁰ Sri Lanka Ports Authority (2011), 'Second phase of H'tota port on schedule', http://portcom.slpa.lk/news_events_264.asp (accessed 5 Feb. 2020).

⁹¹ Friends of the Earth United States (2017), *Investing in a Green Belt and Road? Assessing the Implementation of China's Green Credit Guidelines Abroad*, Washington, DC, https://1bps6437gg8c169i0y1drtgz-wpengine.netdna-ssl.com/wp-content/uploads/2017/12/ChinaGreenBelt_Dec-2017.pdf (accessed 13 Jan. 2020).

⁹² IUCN Sri Lanka and the Central Environmental Authority (2006), *National Wetland Directory of Sri Lanka*, Colombo, [http://www.cea.lk/web/images/pdf/7-1.Book-National-Wetland-Directory-Low%20res\(1\).pdf](http://www.cea.lk/web/images/pdf/7-1.Book-National-Wetland-Directory-Low%20res(1).pdf) (accessed 13 Jan. 2020).

⁹³ United Nations (1992), *Assessment of the Environmental Impact of Port Development*, New York: UN, https://www.unescap.org/sites/default/files/pub_1234_ch2.pdf (accessed 20 Feb. 2020).

⁹⁴ Prasso, S. (2018), 'A Chinese Company Reshaping the World Leaves a Troubled Trail', *Bloomberg*, 19 September 2018, <https://www.bloomberg.com/news/features/2018-09-19/a-chinese-company-reshaping-the-world-leaves-a-troubled-trail> (accessed 20 Feb. 2020).

⁹⁵ Ibid.

⁹⁶ Ibid.

⁹⁷ Central Environmental Authority (2020), 'Acts & Regulations', <http://www.cea.lk/web/en/acts-regulations> (accessed 13 Jan. 2020).

⁹⁸ Central Environmental Authority (n.d.), 'Act No. 47 of 1980', <http://www.cea.lk/web/images/pdf/acts/act47-80.pdf> (accessed 13 Jan. 2020).

activities,⁹⁹ and the legislation sets out levels of acceptable air pollutants and their maximum permissible levels throughout the country.¹⁰⁰ The National Environmental Noise Control Regulations¹⁰¹ regulate the level of noise emitted during industrial and construction activities and stipulate zoning restrictions on urban, rural, residential, commercial and industrial areas.

Sri Lanka has several laws governing EIAs necessary for large development projects.¹⁰² However, the most recent update to EIA legislation was in 2004,¹⁰³ indicating that local EIA standards may not be current with international standards.

While Sri Lanka's environmental laws appear largely comprehensive on paper, there are questions about the extent to which they are enforced.

While Sri Lanka's environmental laws appear largely comprehensive on paper, there are questions about the extent to which they are enforced. Though EIAs have been undertaken for major Chinese investments in Sri Lanka – indeed, they are now standard for development projects in Sri Lanka – there is a lack of clarity about the process.¹⁰⁴ It is unclear, for example, who signs off on the EIAs and what relevant expertise they must have in the field.

The experience of the Norocholai power station, for instance, highlights gaps in the regulatory process. The project began in 2006 despite strong protests from civil society and environmental organizations,¹⁰⁵ who were concerned about the negative health and environmental impacts of coal power generation.¹⁰⁶ They contended that the project had not received the necessary environmental approvals.¹⁰⁷ Yet the Norocholai power station was able to continue operating for 12 years until renewed public protests in 2018.¹⁰⁸ There is currently legal action in Sri Lanka's Supreme Court relating to a fundamental rights application about the environmental damage caused by the Norocholai power station.¹⁰⁹ The project, built with Chinese funding but state-run in Sri Lanka, highlights the recipient country's responsibility to ensure the implementation of environmental laws and standards.

The EIA process would benefit from increased transparency and improved local stakeholder consultation. Members of civil society, the general public and media should have access to the same data used in any given EIA and be given ample opportunity to comment on the outcomes of that

⁹⁹ Central Environmental Authority (2008), 'The Gazette of the Democratic Socialist Republic of Sri Lanka', http://www.cea.lk/web/images/pdf/envprotection/1533_16e.pdf (accessed 13 Jan. 2020).

¹⁰⁰ Central Environmental Authority (2008), 'The Gazette of the Democratic Socialist Republic of Sri Lanka – The National Environmental Act', http://www.cea.lk/web/images/pdf/airquality/1562_22E%20Ambient%20air%20quality%20-%20english.pdf (accessed 13 Jan. 2020).

¹⁰¹ Central Environmental Authority (1996), 'PART I: SECTION (1) GENERAL Government Notifications', <http://www.cea.lk/web/images/pdf/noise/reg924-12.pdf> (accessed 13 Jan. 2020).

¹⁰² Central Environmental Authority (2020), 'Acts & Regulations'.

¹⁰³ Central Environmental Authority (2014), 'Law Policy and Institutional Arrangement for EIA in Sri Lanka', <http://www.cea.lk/web/index.php/en/law-policy-and-institutional-arrangement-for-eia-in-sri-lanka> (accessed 13 Jan. 2020).

¹⁰⁴ Central Environmental Authority (2018), 'Implementation of the EIA process and ensuring compliance', <http://www.cea.lk/web/implementation-of-the-eia-process-and-ensuring-compliance> (accessed 13 Jan. 2020).

¹⁰⁵ *BBC Sinhala* (2005), 'Residents oppose HSZ in Norochcholai', 24 April 2005, https://www.bbc.com/sinhala/news/story/2005/04/050424_norochcholai.shtml (accessed 1 Aug. 2019).

¹⁰⁶ *The Sunday Times, Sri Lanka* (2019), 'Tests show Lakvijaya plant spews out dust 16 times over the limit', 2 June 2019, <http://www.sundaytimes.lk/190602/news/tests-show-lakvijaya-plant-spews-out-dust-16-times-over-the-limit-352005.html> (accessed 1 Aug. 2019); U.S. National Library of Medicine (2017), 'Power Plants'.

¹⁰⁷ De Alwis, N. (2018), 'Licence of harmful ash-spewing Norochcholai Coal Plant suspended', *News First Sri Lanka*, 20 January 2018, <https://www.newsfirst.lk/2018/01/20/licence-harmful-ash-spewing-norochcholai-coal-plant-suspended/> (accessed 2 Aug. 2019).

¹⁰⁸ Wettasinghe, C. (2018), 'New twist to Sri Lanka's impending power crisis', *The Daily Mirror Sri Lanka*, 23 January 2018, <http://www.dailymirror.lk/article/New-twist-to-Sri-Lanka-s-impending-power-crisis--144420.html> (accessed 2 Aug. 2019).

¹⁰⁹ Environmental Foundation (Guarantee) Limited (2019), 'Norochcholai Coal Power Plant', <https://efl.lk/portfolio/norochcholai-coal-power-plant/> (accessed 13 Jan. 2020).

EIA. Large-scale infrastructure projects must be continuously monitored and evaluated with regard to the environmental commitments made at the EIA stage. More formal mechanisms are also required to ensure that issues raised during the EIA are not just flagged but resolved.

Data gaps, transparency and accountability

Some Chinese investments in Sri Lanka, including the Hambantota port and CICT, reveal concerns about the lack of independently gathered and published data, leaving questions around transparency. For instance, the Sri Lanka Ports Authority does not collect data on specific pollution indicators, including carbon and non-carbon emissions, or issue standards for ships on fuel efficiency and fuel sulphur levels or regulate waste-water dumping and the pollution of marine water in Hambantota port operations.¹¹⁰ If levels of carbon and non-carbon emissions are left unchecked, they are likely to cause damage to nearby wildlife habitats in the long term. In the short term, they are expected to cause health and respiratory challenges for the surrounding population.

In addition to the lack of data being collected and monitored, an absence of information and relevant documentation relating to Chinese investments in Sri Lanka has disrupted any comprehensive analysis of the environmental impacts of such investments. In the course of this study, for instance, the EIA for the Hambantota port could not be obtained. The agreements signed between the Sri Lankan government and their Chinese counterparts for several projects considered in this paper were also elusive, to the extent that it was not possible to fully evaluate the environmental concerns and effects.

Conclusion

Chinese investments in Sri Lanka have had various implications for the local labour market and environment. In terms of labour, the absolute number of Chinese workers appears to be relatively small and, contrary to perception, the risk of illegal workers is minimal. However, to reap the benefits of Chinese migrant labour, greater efforts need to be made to attract more highly skilled workers who have the ability to upskill local workers, and to regulate the inward migration of unskilled workers based on market demand. Schemes and incentives should be put in place to encourage skill transfers as well.

As for the environmental implications of Chinese investments, the evidence is mixed. Earlier projects lacked proper oversight and have had a greater negative environmental impact, but recently commissioned projects appear to be making progress in adapting to environmental needs and standards. To make further progress, Sri Lanka should improve its domestic environmental laws in regard to stakeholder consultations and the capacity of the relevant agencies to enforce regulations. Partnering with investors that prioritize green investments would also be beneficial along with introducing a comprehensive incentive scheme that encourages green investment and financing.

¹¹⁰ Sri Lanka Ports Authority (unpublished), 'The Concession Agreement for the Port of Hambantota by Public Private Partnership Hambantota Port Agreement, Government of Sri Lanka, HIPG Pvt. Ltd and HIPS Pvt. Ltd Signed 29 July 2017'.

3. Institutions

Chinese infrastructure projects and related concerns

As detailed in Chapter 1, large Chinese infrastructure projects in Sri Lanka include the Hambantota port development project, Colombo Port City, the CICT terminal of the Colombo port; the Mattala International Airport and International Convention Centre in Hambantota; several expressways; the Norocholai power station; and the newly completed Lotus Tower.

The concerns expressed by commentators and interviewees about these projects include: (i) inadequate policy planning of national infrastructure to ensure feasible,¹¹¹ high-value and apolitical projects;¹¹² (ii) ramifications for national security and sovereignty; (iii) a lack of transparency, stakeholder input¹¹³ and anti-corruption measures to ensure public trust in the projects;¹¹⁴ (iv) their impact on labour and the environment; and (v) potential implications for legal services¹¹⁵ and dispute resolution methods – including the possibility of Chinese law firms in Sri Lanka and of the maritime ‘Belt and Road Court’¹¹⁶ resolving disputes about Chinese investments in Sri Lanka. The labour and environmental concerns have been explored earlier in this paper. As concerns about the implications of Chinese investments on the local legal system appear too preliminary to evaluate, this chapter will assess the first three concerns.

Addressing institutional concerns around Chinese investment

Policy planning concerns: developing critical and high-value infrastructure

A common concern raised in interviews for this paper was that of inadequate, ad hoc¹¹⁷ planning of national infrastructure, which increases the risks of ‘white elephants’ and politically-driven decisions about national infrastructure. Commentators have cited Chinese projects in Hambantota, including the port and an under-utilized new airport, as examples of these risks.¹¹⁸

¹¹¹ *The Sunday Times, Sri Lanka* (2014), ‘Hambantota: Haven for projects’, 30 November 2014, <http://www.sundaytimes.lk/141130/news/hambantota-haven-for-projects-130139.html> (accessed 9 Jan. 2020).

¹¹² Reuters (2013), ‘Sri Lanka takes next step to opening strategic China-built port’, 4 March 2013, <https://www.reuters.com/article/srilanka-port-china/sri-lanka-takes-next-step-to-opening-strategic-china-built-port-idINDEE9230EF20130304> (accessed 9 Jan. 2020).

¹¹³ China Dialogue (2018), ‘Fears grow over Chinese projects in Sri Lanka’, 5 December 2018, <https://www.chinadialogue.net/article/show/single/en/10954-Fears-grow-over-Chinese-projects-in-Sri-Lanka> (accessed 9 Jan. 2020).

¹¹⁴ *Economy Next* (2018), ‘Sri Lanka buries China-related corruption probes?’, 8 July 2018, <https://economynext.com/sri-lanka-buries-china-related-corruption-probes-10764/> (accessed 9 Jan. 2020).

¹¹⁵ *DailyFT* (2019), ‘FR Case filed against Chinese law company’, 17 January 2019, <http://www.ft.lk/business/FR-case-filed-against-Chinese-law-company/34-671015> (accessed 9 Jan. 2020).

¹¹⁶ East Asia Forum (2019), ‘Dispute resolution along the Belt and Road’, 7 June 2019, <https://www.eastasiaforum.org/2019/06/07/dispute-resolution-along-the-belt-and-road/> (accessed 9 Jan. 2020).

¹¹⁷ Mariyathas, S, Perera, N. and Yehiya, M. (2016), ‘What Development Has Done to a Town: Lessons from Hambantota’, *Bhumi, The Planning Research Journal*, 5(1): pp. 57–72, doi:10.4038/bhumi.v5i1.24 (accessed 9 Jan. 2020).

¹¹⁸ *The Sunday Leader* (2015), ‘Hambantota White Projects Eat Up Economy’, 28 June 2015, <http://www.thesundayleader.lk/2015/06/28/hambantota-white-projects-eat-up-economy/> (accessed 9 Jan. 2020).

There is some indication that the concerns about poor infrastructure planning are overstated with respect to Chinese investments in Sri Lanka. This is partly due to critical narratives that are driven more by geopolitical anxiety about China's remarkable rise than facts about Chinese investments.¹¹⁹ Data provided to the authors¹²⁰ on the Hambantota port, for example, demonstrate that arrivals increased from eight vessels in 2017 (when the 99-year lease was announced) to over 290 vessels in 2018. The now apparent success of Colombo port's CICT terminal¹²¹ indicates that, in any event, a port development project can only be assessed after years of operation. In addition, interviewees noted that domestic political factors may encourage the disuse of infrastructure projects, particularly those started by previous governments,¹²² even if the projects were planned according to global best practices.

Notwithstanding the possible overstatement of concerns, there is clear value in devising a detailed, long-term plan for national infrastructure that is empirically driven and publicly available. Such plans limit the scope for inefficiency, including by individual leaders starting or halting a project in ways contrary to the plan. Successive governments of Sri Lanka have released short-to-medium-term plans for infrastructure development, which identify the type (e.g. roads) and sometimes location of planned projects. Recent examples include the Vision 2025 plan launched in 2017, the Public Investment Programme (2017–20), and Ten Year Horizon Development Framework (2006–16) (known as *Mahinda Chintana*).

There is clear value in devising a detailed, long-term plan for national infrastructure that is empirically driven and publicly available.

These plans have been criticized for lacking detail, coherence and stakeholder input.¹²³ Moreover, they are linked to a particular administration, and therefore tend to be discarded by later governments. By contrast, Indonesia, the Netherlands, and New Zealand are among the group of countries¹²⁴ with infrastructure plans for at least 20 years. New Zealand's Treasury devised and launched the country's Thirty-Year Infrastructure Plan 2015.¹²⁵ The plan covers population density and demographic shifts, climate change and other environmental factors, asset management and maintenance projections, technological developments, community and other stakeholder views, rural needs, and international factors. The plan lists major projects until 2045,¹²⁶ noting their type (e.g. roads, internet access, hospitals, water supply, housing, schools, and sports facilities), location and budget.

¹¹⁹ Brautigam, D. (2020), 'A critical look at Chinese "debt-trap diplomacy": the rise of a meme', *Area Development and Policy*, 5(1): 1–14, doi:10.1080/23792949.2019.1689828 (accessed 9 Jan. 2020).

¹²⁰ Author interviews with three officials from the Hambantota International Port Group, who wished to remain anonymous, Hambantota on 21 March 2019.

¹²¹ *DailyFT* (2020), 'CICT ends 2019 with 2.9 m TEUs, 40% of Colombo Port's volume', 1 January 2020, <http://www.ft.lk/front-page/CICT-ends-2019-with-2-9-m-TEUs-40-of-Colombo-Port-s-volume/44-692775> (accessed 9 Jan. 2020).

¹²² Finnigan, C. (2019), 'How a Sri Lankan Port Can Help Integrate the Indian Ocean Economy', *London School of Economics Blogs*, 25 January 2019, <https://blogs.lse.ac.uk/southasia/2019/01/25/how-a-sri-lankan-port-can-help-integrate-the-indian-ocean-economy/> (accessed 9 Jan. 2020).

¹²³ *Economy Next* (2017), 'A critical appraisal of Sri Lanka's Vision 2025', 12 September 2017, <https://economynext.com/a-critical-appraisal-of-sri-lankas-vision-2025-8321/> (accessed 9 Jan. 2020); *Sunday Times* (2007), 'Civil society silent on 10-year plan', 25 February 2007, <http://www.sundaytimes.lk/070225/FinancialTimes/ft335.html> (accessed 9 Jan. 2020).

¹²⁴ Global Infrastructure Hub (2019), *Leading Practices in Governmental Processes Facilitating Infrastructure Project Preparation*, Sydney, https://cib-bic.ca/wp-content/uploads/2019/01/gih_project-preparation_full-document_final_art_web.pdf#page=55 (accessed 9 Jan. 2020).

¹²⁵ New Zealand Government (2015), *The Thirty-Year New Zealand Infrastructure Plan 2015*, Wellington: New Zealand Government National Infrastructure Unit, <https://treasury.govt.nz/sites/default/files/2018-03/nip-aug15.pdf> (accessed 9 Jan. 2020).

¹²⁶ *Ibid.*

Sri Lanka could likewise develop a long-term, empirically based, and less politicized infrastructure plan. It could be formulated by relevant ministries¹²⁷ and the Central Bank of Sri Lanka (CBSL), with public and other stakeholder input, and the input of Sectoral Oversight Committees (SOCs) in Parliament,¹²⁸ whose members represent diverse political parties. Relevant SOCs for infrastructure development include those overseeing energy; sustainable development and environment and natural resources; transport and communication; economic development; and reconciliation and north and east reconstruction.

Sovereignty concerns: Preserving national security

A common critique of Chinese investment projects in Sri Lanka, particularly by foreign commentators, is that they are ‘dual-use’¹²⁹ (for both commercial and military use) and thereby threaten national security. The Hambantota port is often cited as an example of such a potential dual-use facility, due to its 99-year lease by China Merchants Port Holdings Company. Similar concerns have been raised about the potential surveillance and cyber risks of the Lotus Tower in Colombo.¹³⁰ Local commentators have generally couched these concerns in the language of ‘sovereignty’ rather than security.¹³¹ In brief, however, the concern is that Chinese investments may affect Sri Lanka’s control of its own security interests.

There is insufficient information available to assess the security risks of the Lotus Tower, which need to be analysed by experts in light of rapid technological developments. This is also advisable in respect to China’s long-term use of the Hambantota port. However, three points should be considered in the assessment of concerns over a dual-use port.

First, the Hambantota lease agreements explicitly prohibit the port operating companies from conducting or allowing military activities, within the port or on any other Sri Lankan territory, whether on land, in air or at sea.¹³² Likewise, it confirms that the Sri Lankan government has sole authority and power over such activities. Second, as an indication of how Sri Lanka is exercising its sovereign control of the port in practice, it has permitted a number of naval ships to visit Hambantota since 2016. While none of these was a Chinese ship, in 2019 alone, both Japanese and US ships docked at the port.¹³³ In addition, several hundred personnel are stationed at the Sri Lankan Navy (SLN) base in Hambantota, and three units of four officers each patrol the port premises.¹³⁴ Third, Sri Lanka’s authority and power over its ports is externally recognized. Specifically, International Port Security officers of the US Coast Guard audit Sri Lanka’s fulfilment of the International Ship and Port Facility Security Code.

¹²⁷ However, there appears to be a lack of safeguards for an independent civil service, which may require constitutional change; Economy Next (2018), ‘Questions on the legality of Sri Lanka ministry secretaries’, 4 December 2018, <https://economynext.com/questions-on-the-legality-of-sri-lanka-ministry-secretaries-12435/> (accessed 9 Jan. 2020).

¹²⁸ The Parliament of Sri Lanka (2016), ‘Sectoral Oversight Committees’, <https://www.parliament.lk/en/sectoral-oversight-committees> (accessed 9 Jan. 2020).

¹²⁹ Asia Maritime Transparency Initiative (2018), ‘China’s Reach Has Grown; So Should the Island Chains’, <https://amti.csis.org/chinas-reach-grown-island-chains/> (accessed 9 Jan. 2020).

¹³⁰ Jabbar, Z. (2015), ‘Chinese contractor puts India at ease’, *The Island*, 20 April 2015, http://www.island.lk/index.php?page_cat=article-details&page=article-details&code_title=123392 (accessed 9 Jan. 2020).

¹³¹ Weerakkody, D. (2018), ‘SL-China relations: The Great Silk Road needs to pick up speed’, *DailyFT*, 18 May 2018, <http://www.ft.lk/dinesh-weerakkody/SL-China-relations--The-Great-Silk-Road-needs-to-pick-up-speed/5-655327> (accessed 9 Jan. 2020).

¹³² Government of Sri Lanka (2017), ‘The Concession Agreement for the Port of Hambantota: Public-Private Partnership Hambantota Port Agreement’, HIPG Pvt. Ltd and HIPS Pvt. Ltd, 29 July 2017, unpublished.

¹³³ Panditaratne, D. (2020), ‘China’s Commercial and Military Presence in the Indian Ocean: A Perspective from Sri Lanka’, Proceedings from CNA conference on ‘Views of China’s Presence in the Indian Ocean Region’ on 17–18 June 2019, forthcoming.

¹³⁴ Rutnam, E. (2018), ‘Navy strengthens presence in and around Hambantota Port’, *The Morning*, 21 October 2018, <http://www.themorning.lk/hambantota/> (accessed 9 Jan. 2020).

These points demonstrate Sri Lanka's de jure and de facto authority over the Hambantota port. Nevertheless, Sri Lanka must maintain vigilant control over its ports if it is to meet its security objectives, while continuing to permit ships to visit from various countries. Security issues are tied to other institutional concerns, especially those relating to the planning of infrastructure. In an indication of inadequate planning, a decision to move the SLN's Southern Command from Galle to Hambantota was announced in 2016, then re-announced in June 2018 (following controversy about the Hambantota port lease signed in 2017), yet the move had still not taken place by 2019.¹³⁵

Of central importance for future projects is a functional online portal for approvals of foreign investments, akin to the Australian Foreign Investment Review Board (FIRB).¹³⁶ Notably, the FIRB is explicitly mandated to consider national security in its review process, a factor that should be incorporated into the inception of Sri Lanka's approval process, especially for investments in ports or airports, land, telecommunications, or projects involving foreign defence-related companies.

Trust-building measures: Transparency and stakeholder input, and anti-corruption norms

A third set of institutional concerns regarding Chinese investments in Sri Lanka include transparency of investment projects,¹³⁷ the adequacy of stakeholder consultations to improve the utility and reduce any adverse impact of the projects,¹³⁸ and alleged corruption in regard to the projects.¹³⁹ Addressing these is vital to building public trust in infrastructure development projects.

Some national and transnational norms already exist to address these concerns. For example, Sri Lanka has a Right to Information (RTI) Act,¹⁴⁰ which facilitates access to public documents. The Asian Infrastructure and Investment Bank (AIIB), the Chinese-led but multilateral development bank headquartered in Beijing, which approved its first loans¹⁴¹ to Sri Lanka in 2019, gathers stakeholder input through its Environmental and Social Framework,¹⁴² a set of consultative standards modelled on those of the World Bank and ADB. In addition, there is a plethora of anti-corruption laws and institutions in Sri Lanka,¹⁴³ including the Commission to Investigate Allegations of Bribery or Corruption.

¹³⁵ AFP (2018), 'Sri Lanka to base navy's Southern Command at Chinese-run Hambantota port', *South China Morning Post*, 30 June 2018, <https://www.scmp.com/news/china/diplomacy-defence/article/2153246/sri-lanka-base-navys-southern-command-chinese-run> (accessed 9 Jan. 2020); Finnigan (2019), 'How a Sri Lankan Port Can Help Integrate the Indian Ocean Economy'; Ferdinando, S. (2019), 'US-Lanka military exercise in China managed port', *The Island*, 19 April 2019, http://www.island.lk/index.php?page_cat=article-details&page=article-details&code_title=202852 (accessed 9 Jan. 2020).

¹³⁶ The Sri Lankan government launched such a web portal in 2018, which at the time of writing does not appear to be operational, see Board of Investment Sri Lanka (n.d.), 'Single Window Investment Facilitation Taskforce', <http://swiftinvest.lk/investor/#>. A useful overview of how other countries are screening FDI for national security reasons in various ways is available at UNCTAD (2019), 'National Security Related Screening Mechanisms for Foreign Investments', Investment Policy Monitor, Special Issue, https://unctad.org/en/PublicationsLibrary/diaepcbinf2019d7_en.pdf (accessed 20 Feb. 2020).

¹³⁷ Verité Research (2019), 'Sri Lanka urged to develop own narrative of China's BRI', 11 February 2019, <https://www.veriteresearch.org/2019/02/13/sri-lanka-needs-own-narrative-on-bri/> (accessed 9 Jan. 2020).

¹³⁸ Yang, L. (2019), *Assessing the Potential Impact of the Belt and Road Initiative on Sustainable Development Goals in Asian Economies*, Regional Workshop Report, Bangkok: United Nations Department of Economic and Social Affairs, <https://www.brisdgs.org/regional-workshop-report-assessing-potential-impact-belt-and-road-initiative> (accessed 9 Jan. 2020).

¹³⁹ Economy Next (2016), 'Chinese query Sri Lanka allegations of corruption in contracts', 2 November 2016, <https://economynext.com/chinese-query-sri-lanka-allegations-of-corruption-in-contracts-6133/> (accessed 9 Jan. 2020).

¹⁴⁰ Parliament of the Democratic Socialist Republic of Sri Lanka (2016), *Right to Information: Act No. 12 of 2016*, Colombo, <http://www.pmooffice.gov.lk/RTI/RTI%20Act/RTI%20Act%20-%20English.pdf> (accessed 9 Jan. 2020).

¹⁴¹ Asian Infrastructure Investment Bank (2019), 'AIIB Approves USD280 Million for First Two Projects in Sri Lanka', https://www.aiib.org/en/news-events/news/2019/20190404_002.html (accessed 9 Jan. 2020).

¹⁴² Asian Infrastructure Investment Bank (2016), 'Environmental and Social Framework', <https://www.aiib.org/en/policies-strategies/framework-agreements/environmental-social-framework.html> (accessed 9 Jan. 2020).

¹⁴³ United Nations Office on Drugs and Crime (2018), *Country Review Report of Sri Lanka*, Colombo, https://www.unodc.org/documents/treaties/UNCAC/CountryVisitFinalReports/2018_09_03_Sri_Lanka_Final_Country_Report.pdf (accessed 9 Jan. 2020).

Notwithstanding these laws and institutions, there are major challenges to achieving a high degree of transparency and stakeholder engagement, and avoiding corruption, which are necessary for public confidence¹⁴⁴ in large infrastructure projects. For example, the RTI Act limits the need for disclosure when it ‘would undermine ... national security’ or is ‘likely to be seriously prejudicial to Sri Lanka’s relations with any State’ or when the information relates to international obligations provided in confidence.¹⁴⁵ Moreover, despite multiple laws and institutions to curb corruption in Sri Lanka, they are frequently circumvented and lack any real enforcement.¹⁴⁶

Transparency and stakeholder consultations can be strengthened in several ways. First, Sri Lanka’s Board of Investment could hold regular (e.g. quarterly) media briefings, to facilitate transparency by releasing information about foreign investment projects. Freedom of the press is naturally indispensable for transparency. Second, there should be a routine, national process of stakeholder engagement for major development projects¹⁴⁷ (including those funded by the China Development Bank and EXIM Bank China, the two main sources of Chinese loans to Sri Lanka¹⁴⁸), instead of being an externally driven process by the AIIB, World Bank and ADB.

To help counter corruption in foreign investment projects, and indeed in all official decisions with an international angle, Sri Lanka should prohibit political donations from foreign sources.

Finally, to help counter corruption in foreign investment projects, and indeed in all official decisions with an international angle, Sri Lanka should prohibit political donations from foreign sources (a move that could be embedded in a comprehensive law on political donations,¹⁴⁹ which Sri Lanka also lacks). There is a critical need to end the recurrent inefficacy and politicization of national institutions on corruption. President Gotabaya Rajapaksa has expressed commitment to achieving this objective in his national policy framework.

While this research paper focuses on Sri Lankan reforms to maximize the benefits of Chinese investment, the Chinese government also appears to be taking steps to tackle corruption relating to its investments overseas, in line with anti-corruption pledges in the Joint Communique issued after the 2019 Belt and Road Forum. For example, the Chinese Communist Party’s main anti-corruption body, the Central Commission for Discipline Inspection, will reportedly install anti-graft inspectors at project sites.¹⁵⁰

¹⁴⁴ World Bank Group (2019), *Belt and Road Economics: Opportunities and Risks of Transport Corridors*, Washington, DC, <https://www.worldbank.org/en/topic/regional-integration/publication/belt-and-road-economics-opportunities-and-risks-of-transport-corridors> (accessed 9 Jan. 2020).

¹⁴⁵ Section 5(b) (i)–(ii) of the RTI Act. This broad exception appears to be applied in other jurisdictions as well, on the basis of commercial-in-confidence reasons, as has been highlighted in commentary on the confidentiality of terms of a 99-year lease of a Darwin port to a Chinese company signed in 2016. See Walsh, C. (2019), ‘How and why did the Northern Territory lease the Darwin Port to China, and at what risk?’, *ABC News*, 13 March 2019, <https://www.abc.net.au/news/2019-03-12/why-did-northern-territory-sell-darwin-port-to-china-what-risk/10755720> (accessed 9 Jan. 2020).

¹⁴⁶ Sirimanna, B. (2019), ‘PPP infrastructure project procurement undergoes reforms’, *The Sunday Times, Sri Lanka*, 7 April 2019, <http://www.sundaytimes.lk/190407/business-times/ppp-infrastructure-project-procurement-undergoes-reforms-343714.html> (accessed 9 Jan. 2020).

¹⁴⁷ Civil Service College Singapore (2011), ‘Developing Our Approach to Public Engagement’, <https://www.csc.gov.sg/articles/developing-our-approach-to-public-engagement> (accessed 9 Jan. 2020).

¹⁴⁸ Central Bank of Sri Lanka (2018), *Annual Report 2018*.

¹⁴⁹ United Nations Office on Drugs and Crime (2018), ‘Country Review Report of Sri Lanka’.

¹⁵⁰ Commentators have noted that China can also boost international confidence in its outbound foreign investments by implementing a law akin to the US Foreign Corrupt Practices Act. See Ferchen, M. (2019), ‘Why Unsustainable Chinese Infrastructure Deals Are a Two-Way Street’, *Carnegie-Tsinghua Center for Global Policy*, 23 July 2019, <https://carnegietsinghua.org/2019/07/23/why-unsustainable-chinese-infrastructure-deals-are-two-way-street-pub-79548> (accessed 9 Jan. 2020).

Role of Chinese public diplomacy

Despite the above concerns, there remains strong political, academic,¹⁵¹ and public support in Sri Lanka for Chinese investment. One reason for this is China's assistance to the Sri Lankan government during the years of civil war, which it helped to end militarily in 2009.¹⁵²

Another reason, of more recent origin but increasingly significant, is China's growing public diplomacy in Sri Lanka, via multiple intersecting strategies. These strategies include Chinese cultural and language centres in Sri Lanka;¹⁵³ enabling members of parliament,¹⁵⁴ journalists, academics, and business leaders to visit China; funding student scholarships to China; the local presence of Chinese media like China Radio International (CRI) and China Global Television Network (CGTN) in Sri Lanka; promoting cross-country Buddhist links;¹⁵⁵ and supporting local think-tanks¹⁵⁶ and universities – including forums to discuss Chinese projects.¹⁵⁷ These strategies largely resemble the public diplomacy methods of Western nations.¹⁵⁸

A key trend in Chinese public diplomacy in Sri Lanka is an emergence of corporate social responsibility (CSR) activities by Chinese companies. For example, CHEC Port City Colombo (CPCC), a local subsidiary of China Communications Construction Company, which is developing the Colombo Port City, spent roughly \$3 million from 2016 to 2019 to support around 9,000 fishing families that were potentially affected by the project.¹⁵⁹ To achieve this, it worked with local fishing associations, the Fisheries Ministry and other relevant ministries to disburse funds to bolster the industry, including an upgrade of coastal environments for fishing.¹⁶⁰ In addition, CPCC has engaged in broader public diplomacy by inviting public officials,¹⁶¹ professionals, students,¹⁶² academics and journalists to visit its modern sales gallery to visualize and learn about the project. Such measures, alongside public advertising and active social media, appear to be effective in building broader support for the project.¹⁶³

¹⁵¹ Otero-Iglesias, M. (2018), 'Is Sri Lanka caught in China's 'debt trap'? A view from the ground', *Real Instituto Elcano* blog, 21 November 2018, <https://blog.realinstitutoelcano.org/en/is-sri-lanka-caught-in-chinas-debt-trap-a-view-from-the-ground/> (accessed 9 Jan. 2020).

¹⁵² The National (2009), 'China's aid revealed in Sri Lanka's victory parade', 9 June 2009, <https://www.thenational.ae/world/asia/china-s-aid-revealed-in-sri-lanka-s-victory-parade-1.556125> (accessed 20 Feb. 2020). China has continued to provide security-related assistance to Sri Lanka, most recently after the Easter attacks in 2019. See Xinhua (2019), 'Confucius Institute of the University of Colombo Sri Lanka', 27 September 2019, http://www.xinhuanet.com/english/2019-09/27/c_138429199.htm (accessed 9 Jan. 2020).

¹⁵³ Confucius Institute of the University of Colombo (2019), 'Confucius Institute of the University of Colombo Sri Lanka', <https://ciuc.cmb.ac.lk/> (accessed 9 Jan. 2020).

¹⁵⁴ *Daily Mirror* (2019), 'Parliamentary Delegation Visit to China', 4 July 2019, <http://www.dailymirror.lk/news/Parliamentary-delegation-to-visit-China/239-170524> (accessed 5 Feb. 2020).

¹⁵⁵ Embassy of the People's Republic of China in Sri Lanka (2015), 'Sri Lankan Buddhist delegation participating in the 4th World Buddhist Forum in China', <http://lk.china-embassy.org/eng/xwtd/t1311063.htm> (accessed 9 Jan. 2020).

¹⁵⁶ *DailyFT* (2018), 'Pathfinder Foundation opens 'China-Sri Lanka Cooperation Studies Centre'', 18 December 2018, <http://www.ft.lk/news/Pathfinder-Foundation-opens---China-Sri-Lanka-Cooperation-Studies-Centre-/56-669107> (accessed 9 Jan. 2020).

¹⁵⁷ Otero-Iglesias (2018), 'Is Sri Lanka caught in China's 'debt trap'? A view from the ground'.

¹⁵⁸ Wijesinghe, J. (2017), 'Way forward for Sri Lankan diplomacy', *Daily News Sri Lanka*, 19 July 2017, <http://www.dailynews.lk/2017/07/19/features/122467/way-forward-sri-lankan-diplomacy> (accessed 9 Jan. 2020). For example, China is now visibly supporting western classical music in Sri Lanka. *DailyFT* (2018), 'CMSC awarded special cultural grant by Chinese Embassy in SL', 5 October 2018, <http://www.ft.lk/entertainment-sectors/CMSC-awarded-special-cultural-grant-by-Chinese-Embassy-in-SL/10405-664089> (accessed 9 Jan. 2020).

¹⁵⁹ CHEC Port City Colombo (2019), 'Port City completes Rs. 500 m livelihood support program', 9 July 2019, <https://www.portcitycolombo.lk/press/2019/07/09/port-city-completes-rs-500-m-livelihood-support-program.html> (accessed 20 Feb. 2020). (1 USD = LKR 181.72 conversion as of 23 Feb. 2020).

¹⁶⁰ Author interviews with three officials at Colombo Port City, who wished to remain anonymous, 4 December 2019.

¹⁶¹ *The Morning* (2019), 'Lord Naseby visits Colombo Port City', 19 September 2019, <http://www.themorning.lk/lord-naseby-visits-colombo-port-city/> (accessed 9 Jan. 2020).

¹⁶² Port City Colombo (@PortCityColombo) (2019), '#PCC was the proud sponsor of the Amalgamated Club', tweet, 16 October 2019, <https://twitter.com/PortCityColombo/status/1184370329105379328> (accessed 9 Jan. 2020).

¹⁶³ For example, Getty Images (2018), 'Construction and Development at the Port City Colombo Project', <https://www.gettyimages.com/detail/news-photo/pedestrians-walk-past-a-hoarding-featuring-an-artists-news-photo/954052982>; Port City Colombo (@PortCityLK) (2020), Facebook page, https://www.facebook.com/PortCityLK/?ref=br_rs (accessed 9 Jan. 2020).

The combined effect of the above-mentioned measures is to increase public appreciation of Chinese investment projects¹⁶⁴ and to soften concerns about institutional decision-making outlined in this chapter. While Chinese public diplomacy is beneficial in increasing broad public support for (and use of) investment projects, public institutions must nevertheless be firmly rooted in empirical decision-making when initiating and developing such projects.

Conclusion

Local commentary and interviews in Sri Lanka confirm that the recent growth of Chinese investment is generally welcomed. At the same time, the scale of investment, entailing the significant involvement of local resources and stakeholders, has generated concerns that show there is a need for national institutions to plan projects according to empirical and fiscally sound criteria, to consider their security dimensions, and to ensure public trust in investment projects by disseminating accurate information, engaging the public, and combating any signs of corruption. These outcomes are in the interests of both Sri Lanka and China, which are deeply invested in the success of the projects, though in different ways.

¹⁶⁴ *DailyFT* (2017), 'China is key to Sri Lanka's progress: survey', 18 August 2017, <http://www.ft.lk/article/636090/China-is-key-to-Sri-Lanka-s-progress--survey> (accessed 9 Jan. 2020). According to the survey, 72 per cent of those surveyed believe that China is key to Sri Lanka's progress (42 per cent believed the same of India). See also Staniland, P. (2019), 'Approval of Chinese and American leadership in South Asia', *Paul Staniland* blog, 8 May 2019, <https://paulstaniland.com/2019/05/08/approval-of-chinas-leadership-in-south-asia/> (accessed 9 Jan. 2020).

4. Policy Implications and Recommendations

Sri Lanka and China have enjoyed close diplomatic relations for decades, which have evolved into an economic relationship in the infrastructure sphere. Chinese infrastructure investment in Sri Lanka began before the BRI was launched in 2013 and has continued in recent years. The evidence-based study undertaken for this paper pointed to various national benefits and costs from the overall pattern of Chinese infrastructure investment in Sri Lanka, between 2006 and 2019, in the areas of economics, labour, environment and institutions. The study also showed that projects differ in their cost-benefit calculus with some projects generating larger net benefits than others. The new administration of President Gotabaya Rajapaksa, formed in late 2019, has set out a national policy framework with some emphasis on an infrastructure-led growth model of economic development for Sri Lanka to reach high-income status.¹⁶⁵ It is clear that existing projects with Chinese participation will remain prominent and new Chinese investments are under discussion.

Accordingly, the crucial development challenge for Sri Lanka is how best to ensure net benefits across the project portfolio of Chinese infrastructure investments. Meanwhile, China's challenge is how to further its reputation as a responsible global economic partner. It is useful to explore policy implications to achieve both outcomes.¹⁶⁶

Improving debt management

The research for this paper has confirmed previous findings that Sri Lanka may have a general foreign debt problem,¹⁶⁷ but not a Chinese debt problem per se. Nonetheless, it would be prudent to reduce the risk of Sri Lanka falling into a Chinese debt trap in the future. An initial step would be for Sri Lanka to appoint a committee of independent experts to study the treasury and debt implications of projects with Chinese participation. In addition, the country could strengthen its debt management system to reduce debt-related vulnerabilities and improve debt transparency (particularly in infrastructure projects) with technical assistance from the International Monetary Fund (IMF) and the World Bank. Sri Lanka might also request a moratorium on interest payments of Chinese debt for three years to facilitate overall debt sustainability.¹⁶⁸ Over time, Sri Lanka could also look to increase its share of infrastructure financing from the AIIB, which offers relatively low-cost infrastructure financing at high procurement and environmental standards. The AIIB started lending to Sri Lanka

¹⁶⁵ Ministry of Finance Sri Lanka (2019), *National Policy Framework, Vistas of Prosperity and Splendour- Summary*, Colombo, <http://www.treasury.gov.lk/documents/10181/791429/FinalDovVer02+English.pdf/> (accessed 5 Feb. 2020).

¹⁶⁶ For instance, Saravanamuttu argues that 'it's time now for Sri Lanka to give China an opportunity to prove its peaceful and commercial intentions in the Indian Ocean, by exploring the possibility of rules-based regional engagement'. Saravanamuttu, P. (2019), 'The Belt and Road Initiative and Sri Lanka – China Relations', LKI *The Prospector* blog, 3 June 2019, <https://www.lki.lk/blog/the-belt-and-road-initiative-and-sri-lanka-china-relations/> (accessed 10 Feb. 2020). Likewise, Jayamaha argues that 'Sri Lanka should have a consistent policy framework comprising a supportive legal and regulatory structure, strong project management and transparent procurement procedure', Jayamaha, R. (2019), *5 Years into the BRI Initiative: Potential Economic Benefits and opportunities for Sri Lanka*, Research paper, Colombo: Regional Centre for Strategic Studies, <https://rcss.org/2020/01/06/publications/five-years-into-belt-and-road-initiative-bri-potential-economic-benefits-and-opportunities-for-sri-lanka-by-dr-ranee-jayamaha/> (accessed 10 Feb. 2020).

¹⁶⁷ International Monetary Fund, Asia and Pacific Dept (2019), *Sri Lanka: Fifth Review Under the Extended Arrangement Under the Extended Fund Facility*, Washington, DC, <https://www.imf.org/en/Publications/CR/Issues/2019/05/15/Sri-Lanka-Fifth-Review-Under-the-Extended-Arrangement-Under-the-Extended-Fund-Facility-46900> (accessed 5 Feb. 2020).

¹⁶⁸ DailyFT (2020), 'SL requests three-year moratorium from India', 10 February 2020, <http://www.ft.lk/front-page/SL-requests-three-year-moratorium-from-India/44-695392> (accessed 16 Mar. 2020).

in 2019 and has only approved two projects to date. With a relatively low cost and high reputational impact, China can provide resources for IMF and World Bank technical assistance in Sri Lanka and encourage the AIIB to upscale its activities in the coming years.

Reducing the trade deficit

The increase in Chinese infrastructure projects is associated with rising Chinese imports and the poor performance of Sri Lankan exports to China. Sri Lanka's growing trade deficit with China could potentially be offset by FDI from China. However, to date, Sri Lanka has only seen a trickle of export-oriented FDI from China.¹⁶⁹ Sri Lankan firms have difficulty exporting to China due to tariffs, non-tariff measures, poor market information and the Chinese language. A much more concerted effort is required to market Sri Lanka in China as an investment and export destination and to improve its domestic FDI regime. To achieve this, Sri Lanka could establish a combined and well-resourced investment and export promotion office in a major business hub like Shenzhen, staffed by marketing professionals with business expertise and Chinese-language skills. This could be set up as a pilot project and replicated in other business hubs in China if successful. Another method of promoting Sri Lanka is to revamp the country's unattractive FDI regime by introducing selective tax incentives for strategic investment projects, streamlining business regulations facing investors, and ensuring a predictable macroeconomic environment.

Promoting domestic spillovers

To date, Sri Lanka has had limited indirect spillovers from Chinese projects such as sectoral shifts, exports and employment. This is a complex economic issue, but investment in and support of the industrial zone adjacent to the Hambantota port may improve the situation. In the wake of rising wages in China and an economic slowdown, international and Chinese investors are looking to relocate manufacturing activities to other parts of Asia, such as Sri Lanka. China can facilitate outward FDI to Sri Lanka by providing incentives for Chinese SOEs to relocate to the Hambantota industrial zone and to undertake supplier development programmes that foster linkages with local small and medium-sized enterprises (SMEs) and create local jobs. As mentioned above, Sri Lanka needs to improve its marketing efforts in China and its FDI regime.

Enhancing skill transfers

There is little evidence to support the view that Chinese projects are mostly staffed by Chinese workers or that illegal Chinese migrant workers are a major problem in Sri Lanka. Instead, relatively small inflows of unskilled, skilled and professional manpower have mitigated domestic labour shortages in the construction industry and resulted in some skill transfer from abroad. Sri Lanka could introduce legislation to incentivize firms that employ foreign workers to increase training of local workers and formally report their efforts.

¹⁶⁹ On attracting export-oriented FDI to Sri Lanka from China and elsewhere, see Kamardeen, N. and Panditaratne, D. (2019), 'The Regulation of Foreign Investments in Sri Lanka: A Policy-Based Perspective', LKI Working Paper Series, pp. 16–22, https://www.lki.lk/wp-content/uploads/2019/01/LKI_Working_Paper_The_Regulation_of_Foreign_Investments_in_Sri_Lanka_A_Policy_Based_Perspective_Naazima_Kamardeen_Dinusha_Panditaratne.pdf (accessed 20 Feb. 2020).

To attract more high-skilled labour with the potential to add greater value, Sri Lanka should introduce an efficient online visa system that facilitates online submission of documents (including skill transfer plans) and scheduling of convenient appointments. To reduce the risk of illegal unskilled migration, a guest worker scheme should be introduced for temporary workers, based on labour market demand. The National Human Resources Development Council should be mandated with a manpower planning function that matches economy-wide labour demand with potential labour supply. Closer coordination with the Immigration Department and other agencies will help enforcement and in creating a database on migrant workers, who should also be protected against any discrimination. To control outflows of illegal emigrants and combat people smuggling by organized crime syndicates, China recently established a National Immigration Administration under the Ministry of Public Security.

Strengthening environmental protection

Chinese investment projects in Sri Lanka have had a mixed impact on the local environment. While newer projects like the CICT terminal have minimal environmental impact due to adherence to standards, older projects like the Norocholai power station have been more harmful to the environment. In future, Sri Lanka should improve domestic environmental standards and enforcement for infrastructure projects. These standards should mirror international standards and encourage working with innovative partners in green technology and green financing systems. The goal should be to attract projects and investors that prioritize environmental protections in their investment. The planning and design stage of infrastructure projects should also consider the SDGs. Sri Lanka could introduce incentives for projects that meet a minimum requirement of green, innovative or energy-saving technology that are implemented in the country. The EIA process could benefit from enhanced transparency and local stakeholder consultation.

Improving infrastructure planning

There are several prominent concerns about the implications of Chinese investment for institutions in Sri Lanka, including the need for empirically sound planning of national infrastructure projects, and concerns about national security in regard to port development projects. Research for this paper found some fears to be overstated, due to the geopolitical tensions between a rising China and its competitors, which incentivize critical narratives of Chinese investment. Nevertheless, Sri Lanka should look to end its inefficient and potentially costly practice of devising broad infrastructure plans in each electoral cycle and adopt the practice, followed by more successful economies, of devising detailed infrastructure development plans that span 20 years or more, which are data-driven, including in regard to demographic trends, environmental factors, technological development and international partnerships. FDI approvals should be digitized in a user-friendly way and streamlined under a single approvals body that considers national security implications of investment projects.

Ensuring public trust

There is a need for public trust in infrastructure development projects funded by China and processes to ensure this is achieved, namely transparency, stakeholder engagement and anti-corruption measures. Remedies include amendments to the RTI Act to remove or limit exceptions

related to public disclosure, and holding regular media briefings to disseminate accurate information about Chinese projects. Other recommended steps include requiring relevant ministries to undertake stakeholder consultations on large infrastructure projects. Sri Lanka should also consider prohibiting foreign political donations, a move that could potentially be complemented by greater oversight of outbound investment projects by China's Central Commission for Discipline Inspection.

The Sri Lankan experience of Chinese infrastructure investment offers useful lessons for other countries that are turning to China for investment, particularly in the developing world. But as countries differ in their institutional and policy conditions, insights from the Sri Lankan experience should be considered in the context of individual national circumstances.

Acknowledgments

The views expressed in this study are solely those of the authors and do not represent the official view of the Lakshman Kadirgamar Institute of International Relations and Strategic Studies or its Board of Management, or any other institution with which the authors are affiliated.

The authors would like to extend our appreciation to the International Development Research Centre and the Konrad-Adenauer-Stiftung Foundation for their generous support of this research. Their support funded a high-level expert roundtable and panel discussion in Sri Lanka and enabled the extensive fieldwork for this research paper.

Fieldwork was undertaken at several project sites in Colombo and Hambantota, including the Colombo Port City, the CICT terminal of the Colombo port, the Hambantota port and the Magampura Mahinda Rajapaksa International Convention Centre, and Mattala International Airport. We also undertook interviews at relevant institutions such as the Board of Investment, the Central Bank of Sri Lanka, Ministry of Finance, Ministry of Defence, and the Sri Lanka Navy, among others. We wish to express our thanks to all who facilitated these visits and participated in interviews and meetings. The study also benefited from the insights of experts at the launch of this study on 1 November 2018 in Colombo, including Professor Katherine Adeney, Dr Chulanee Attanayake, Professor Xiong Bin, Dr Alex Lechner, Dr Li Li, Dr S. D. Muni, Dr Selim Raihan, and Professor Lutz-Christian Wolff. We are particularly grateful to Grace Asirwatham, Vice Admiral Piyal de Silva, Dr Paikiasothy Saravanamuttu and Dr Dushni Weerakoon.

We are grateful to Dr Champa Patel, Chloe Sageman and the Chatham House publications team for their collaboration and meticulous editing of the report, as well as their feedback, support and patience throughout the process. Finally, thanks are also due to the anonymous reviewers and to other colleagues at Chatham House for their helpful comments and suggestions on earlier drafts of this paper, as well as to the supporters of Chatham House's Asia-Pacific Programme.

About the Authors

Dr Ganeshan Wignaraja is the executive director of the Lakshman Kadirgamar Institute of International Relations and Strategic Studies (LKI) in Sri Lanka. He concurrently serves as a member of the Monetary Policy Consultative Committee of the Central Bank of Sri Lanka. He is also a senior research associate at the Overseas Development Institute in London. In a career spanning over 25 years in the UK and Asia, Ganeshan has had senior roles in international organizations (director of research at the ADB Institute in Tokyo) and the private sector (global head of trade and competitiveness at Maxwell Stamp PLC in London). Ganeshan has a DPhil in economics from Oxford University and has published 18 books on international trade, economic development and macroeconomics.

Dr Dinusha Panditaratne is a non-resident fellow of the LKI. She previously served as executive director of LKI (2015–18). Prior to her appointment at the LKI, Dr Panditaratne was an assistant professor at the Faculty of Law at the Chinese University of Hong Kong, and a visiting fellow at the University of Hong Kong. She is an attorney admitted to practice in the State of New York and previously worked at Milbank LLP. Dr Panditaratne is a member of the Asia-Pacific Leadership Network for Nuclear Non-Proliferation and Disarmament (APLN) headquartered in Seoul, and an adviser to Verité Research, a private think-tank in Colombo. She is also a non-executive director of a leading bank and two civil society organizations in Sri Lanka. She received her first degree in law from Oxford University and a masters and a doctorate from Yale Law School.

Pabasara Kannangara has worked at the LKI since 2017 and is a research associate in the Global Economy team. Her research and capacity-building work covers international trade, maritime affairs and political economy issues related to Sri Lanka and Asia, as well as statistical data analysis. She has published research on the development of sea ports in India and Sri Lanka, Indian Ocean dynamics and Chinese investment. She is currently working on research related to the macroeconomic outlook for Asia, mapping maritime-led growth in the Commonwealth region, Sri Lanka's transition from lower-middle to upper-middle-income status, and economic diplomacy. Pabasara completed her BSc (Hons) in economics at the University of Warwick.

Divya Hundlani is an independent researcher and academic writer in the public policy field. Divya has worked at Singapore's Earth Observatory Unit, where she studied the economic impact of reconstruction in post-disaster environments. She subsequently joined the LKI as a research fellow, where she worked on Sri Lanka's foreign policy issues related to economics, environmental studies and international governance. Divya completed a masters of public policy at the Lee Kuan Yew School of Public Policy at the National University of Singapore in 2014 and received a bachelor's degree in economics from the University of Miami in the US.

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Cover image: Workers unload cargo from the first vessel to enter the newly built Chinese-funded port in Hambantota, 18 November 2010.

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ISBN 978 1 78413 384 9

This publication is printed on FSC-certified paper.



Typeset by Soapbox, www.soapbox.co.uk

The Royal Institute of International Affairs
Chatham House
10 St James's Square, London SW1Y 4LE
T +44 (0)20 7957 5700 F +44 (0)20 7957 5710
contact@chathamhouse.org www.chathamhouse.org

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