BALANCING INDIA AND CHINA:
A Case Study of Sri Lanka

December 2024

BALANCING INDIA AND CHINA:
A Case Study of Sri Lanka[1]

December 2024
(Last Edited: 22 January 2025)

The Economics Team of Verité Research compiled the study. The team comprised of Subhashini Abeysinghe, Mathisha Arangala, Dilushi Siriwardena and Malinda Meegoda. Editorial support was provided by Nishan de Mel.

Balancing India and China : a case study of Sri Lanka / comp. Subhashini Abeysinghe...[et al.]. - Colombo : Veritè Research, 2024. 58 p. : col.ill ; 29 cm. -

ISBN 978-624-5514-34-2

i. 338.91505493 DDC23

ii. Abeysinghe, Subhashini (comp.)

iii. Balancing India and China: a case study of Sri Lanka

1. Economic assistance
2. China-International economic relations
3. India-International economic relations

ISBN 978-624-5514-34-2

Verité Research aims to be a leader in the provision of information and analysis for negotiations and policy making in Asia, while also promoting dialogue and education for social development in the region. The firm contributes actively to research and dialogue in the areas of economics, sociology, politics, law, and media, and provides services in data collection, information verification, strategy development and decision analysis.

Recommended Citation: Verité Research (2024). Balancing India and China: A Case Study of Sri Lanka, Colombo: Verité Research, 2024.

Keywords: Economic assistance, Sri Lanka - India relations, Sri Lanka - China relations, Project financing – India, Project financing – China.

Other insights and analysis can be found at: https://www.veriteresearch.org

Email comments to: publications@veriteresearch.org

Table of Contents

List of Abbreviations

ADB	-	Asian Development Bank
BOI	-	Board of Investment
BRI	-	Belt and Road Initiative
CCEM	-	Cabinet Committee on Economic Management
CEA	-	Central Environmental Authority
CEB	-	Ceylon Electricity Board
CHECI	-	China Harbour Engineering Company
CICT	-	Colombo International Container Terminals Limited
CKD	-	Chronic Kidney Disease
DFC	-	Development Finance Cooperation
EIA	-	Environmental Impact Assessment
ERD	-	External Resources Department
FDI	-	Foreign Direct Investment
G2G	-	Government-to-Government
GAMWS	-	Gampaha, Attanagalla, Minuwangoda Water Supply
GDA	-	Governance Diagnostic Assessment
GDP	-	Gross Domestic Product
IDPs	-	Internally Displaced Persons
IMF	-	International Monetary Fund
ISB	-	International Sovereign Bond
JICA	-	Japan International Cooperation Agency
KKS	-	Kankesanthurai
LTTE	-	Liberation Tigers of Tamil Eelam
MEA	-	Ministry of External Affairs, India
MoC	-	Memorandum of Cooperation

ORF	-	Observer Research Foundation
PAA	-	Project Approving Agency
PIP	-	Public Investment Programme
PPP	-	Public Private Partnership
RDA	-	Road Development Authority
RTI	-	Right to Information
STP	-	Strategic Development Project
SOE	-	State Owned Enterprise
USP	-	Unsolicited Proposal

Summary

Geopolitical context

Over the past decade, South Asia has emerged as a critical arena of strategic rivalry and competition between China and India. As China's Belt and Road Initiative (BRI) seeks to expand its influence in the Indian Ocean region, India's "Neighbourhood First" policy aims to counterbalance Beijing's ambitions.

Sri Lanka, strategically located in the Indian Ocean in close proximity to India and major shipping routes, is an instructive case study of the tightrope balancing act of smaller states caught in increasing competition and rivalry between these two Asian giants. Its experience provides valuable insights into opportunities, challenges, and pitfalls faced by countries in similar situations. It also sheds light on how smaller nations can effectively manage the competing interests and concerns of global and regional powers with their own development needs and priorities.

Geopolitical Opportunities

Sri Lanka's strategic location, combined with evolving geopolitical dynamics, have facilitated an increased inflow of financial resources from India and China in the last two decades. Between 2000 to 2023, these countries —previously negligible sources of bilateral finance— became Sri Lanka's leading bilateral lenders. China accounted for 45% of bilateral loan commitments, and India 23%.

During 2010-2014, China became the leading source of finance for the Sri Lankan government's ambitious large infrastructure-led development strategy. The alignment between Sri Lanka's geographical advantage and China's strategic interest in securing critical sea lanes vital for energy security appear to have contributed to this surge of financial inflows. Approximately 75% of funding from China during this period was directed towards infrastructure projects in the Southern and Western Provinces located near the busy East-West shipping route in the Indian Ocean.

India became a leading source of finance for the reconstruction of infrastructure in the war-torn Northern Province. Following the conclusion of the three-decade-long armed conflict in 2009, the Sri Lankan government sought funds to rebuild the infrastructure in the Northern and Eastern Provinces, which were most severely affected by the conflict. India's strategic interest in the Northern Province, owing to its proximity to India and its ethnic ties with the Tamil community, enabled Sri Lanka to secure funding from India for reconstruction efforts. Between 2010 and 2014, 70% of India's financial assistance was allocated to rebuilding the Northern Province.

Geopolitical Challenges

Between 2000 and 2014, the geopolitical rivalry between India and China had not yet emerged as a significant issue faced by South Asian countries like Sri Lanka. During this period, financing decisions by India and China were driven by their respective interests and strategic priorities, rather than the competition and rivalry between them. As a result, Sri Lanka was able to balance its engagements with India and China bilaterally, independently of each other.

Post-2014, several developments, including the launch of the BRI, China's increased influence in South Asia and the 2020 military clash between India and China in the Galwan Valley, strained the relationship between Delhi and Beijing. This intensification of strategic rivalry in recent years has compelled Sri Lanka to shift from bilateral balancing to a delicate trilateral balancing, striving to accommodate interests of both Nations while securing critical funding to meet its development needs. For example, in recent years, India has demonstrated greater interest in expanding its footprint in strategic locations outside the Northern Province to counter the influence of China. At the same time, China, which has previously been content to be outside the Northern Province, has shown interest in extending financial assistance to the region.

India's heightened security concerns, particularly in strategically sensitive regions such as the Northern Province, have made it proactively push back on any form of Chinese engagement in the region. This opposition has extended beyond infrastructure projects funded by China to include projects funded by third parties, such as the Asian Development Bank (ADB), where contracts were awarded to Chinese firms through competitive bidding. Sri Lanka's experience highlights the geopolitical pressures on domestic policymaking encountered by small states amidst increasing competition and rivalry between these two Asian powers.

Pitfalls and hidden costs

Three factors that initially made loans and investments from China and India appealing were also instrumental in undermining the country's ability to channel them effectively towards development. <u>The first</u> was the financial appeal, where the cost of loans was lower than the alternative of issuing International Sovereign Bonds (ISBs). However, the case study reveals that over 60% of loans from China and 58% of loans from India were non-concessional. Moreover, the financial benefits of the loans were frequently negated by restrictive procurement conditions that required bypassing competitive bidding, leading to higher project costs. <u>The second</u> factor was the political appeal driven by the ability to expedite projects due to the lack of stringent external scrutiny by lenders over feasibility and environmental and social compliance. <u>The third</u> factor was the private appeal, i.e., the rent-seeking opportunities or opportunities for private gain created by the absence of external and internal oversight.

Safeguards

Weak institutional and regulatory frameworks, coupled with a lack of accountability and opacity in decision-making processes, have been critical factors that undermined Sri Lanka's ability to effectively utilize the increased flow of financing from China and India. Countries like Sri Lanka can take several actions to safeguard national interests from external geopolitical pressures and the exploitation of these dynamics by vested interests at home and abroad. These include:

Establishing a robust, transparent, and accountable public procurement framework that gives prioritises open competitive bidding is paramount. Such a framework can shield decision-making from external geopolitical pressures and ensure that decisions align with the country's needs through thorough economic impact assessments.

Prioritising projects including those that originated as public-private partnerships (PPPs) within a Public Investment Programme (PIP). Such a programme aligned with the country's national needs and strategic priorities can help depoliticise the decision-making process.

Ensuring strict compliance with laws mandating information disclosure for foreign and locally funded development projects. Legal transparency mandates, like Sri Lanka's Right to Information (RTI) Act, aim to prevent vested interests from capturing decision-making and enhance accountability. Improved compliance can enhance accountability and allow greater public scrutiny and pushback on vested interest capture of critical decisions. International lenders and foreign governments can significantly enhance transparency by linking their lending to compliance with local laws on information disclosure.

01 Introduction

1.1. The Context

South Asia has emerged as a critical arena of increasing geopolitical competition and rivalry between India and China. This strategic rivalry has escalated as China expands into India's traditional sphere of influence, leveraging its extensive financial resources and the surplus capacity of its state-owned enterprises (SOEs). These efforts have been shaped by China's "Going Global" policy initiated in the late 1990s, its Belt and Road Initiative (BRI) launched in 2013 and its strategic need to secure critical energy routes. In response, India – asserting its position as a rising global power – has ramped up financial assistance to the region to counter China's expanding footprint, which it perceives as a threat to its sovereignty, security and regional influence. India's "Neighborhood First" policy, introduced in 2015, exemplifies its effort to match China's influence and contain its rival's growing reach.

These developments compel smaller South Asian countries to engage in a complex balancing act between Beijing and New Delhi. India and China are critical trading partners, significant investors and important sources of finance in the region. Accepting financial support from both can unlock valuable economic opportunities for these countries, but leaning too heavily toward one side risks alienating the other, potentially jeopardising diplomatic and economic relations. As geopolitical tensions between India and China escalate, smaller South Asian countries must delicately navigate the competing interests of the two major powers while addressing their own economic priorities.

1.2. Objective

This research paper examines Sri Lanka's experience as a case study of the opportunities, challenges and pitfalls smaller South Asian countries encounter in their attempt to secure funding from India and China while balancing their competing interests and concerns.

Sri Lanka is a lower middle-income country with a GDP of USD 85 billion, a population of 22 million and a land area of 65,610 km.[2] The strategic location of this small island nation in the Indian Ocean makes it an instructive case study. Its proximity to crucial shipping lanes in the Indian Ocean – which handle half of the world's containerised cargo, one-third of the bulk cargo and two-thirds of the oil shipments – makes it a focal point for China in securing influence over the country's strategic maritime locations. Meanwhile, Sri Lanka's proximity to India heightens New Delhi's concerns about Beijing's growing influence, which India surmises as a threat to its national security. For instance, China's substantial investments in Sri Lankan ports, viewed by India as "dual-use facilities", are seen as inimical to its strategic interests as a rising power.

From the outset, Sri Lanka appears to have benefitted from the growing competition between India and China by securing funding from both countries without fully committing to either. For example, China and India, negligible sources of foreign finance before 2000, emerged as the two leading bilateral sources of finance during 2000 - 2023 to Sri Lanka. Together, they accounted for 68% of Sri Lanka's total bilateral loan commitments during this period. However, this case study that delves deep into Sri Lanka's engagement with India and China reveals significant dilemmas and pitfalls encountered by countries like Sri Lanka, undermining their ability to make the best use of the opportunities. It provides valuable insights into how weak institutional and legal frameworks in countries like Sri Lanka that lack transparency and accountability allow private and vested interests to shape funding engagements, overlooking the country's needs and priorities.

In view of the above, this case study uses Sri Lanka's experience as an illustrative example of the complexities and consequences faced by the smaller developing countries caught between intensifying competition and rivalry between global and regional powers. Focusing on the interplay between opportunities and risks, the case study demonstrates how inadequate external and internal safeguards can yield outcomes favouring a narrow set of interests over broader national priorities. While drawn from Sri Lanka's context, the insights and recommendations are relevant and beneficial to other developing nations in South Asia and elsewhere as they navigate similar geopolitical pressures.

1.3. Methodology

This study examined how Sri Lanka managed its relationships with India and China through the lens of project financing. It analysed three categories of external financial inflows: loans, grants and strategic investments from 2000 to 2023. The research primarily relies on official loan and grant commitments recorded by the External Resources Department (ERD) of Sri Lanka's Ministry of Finance rather than actual disbursements.[1] Secondary research, data and key findings were validated and enriched through interviews with senior public and private sector officials and academics familiar with the region's economic and foreign policy landscape.

1. Loan and grant disbursements can occur over a longer period of time and are influenced by multiple factors, such as bureaucratic red tape and delays in project implementation, which largely fall outside the scope of this case study.

To illustrate the evolving nature of Sri Lanka's engagement with India and China, the analysis explores the engagement across periods characterised by unique economic challenges, political shifts, development strategies and geopolitical considerations. It provides insights into opportunities, challenges and pitfalls the country faced during this period by analysing:

Financial flows over time: Changes in the volume and composition of loans, grants and strategic investments.

Geographical and sectoral patterns: The distribution of projects across different regions and economic sectors within Sri Lanka.

Cost of financing: The interest rates, fees and repayment associated with each source of funding.

Contractual conditions: The specific terms, conditions and expectations tied to these financial commitments, including restrictions on the procurement of contractors and materials.

1.4. Structure of the case study

The study's findings and recommendations are organised into four sections, each highlighting a critical takeaway:

Section 2 focuses on understanding the opportunities. It identifies the emergence of China and India as new sources of finance and investments as key opportunities. This section explores how Sri Lanka managed this opportunity while balancing the interests and concerns of China and India and its own needs and priorities.

Section 3 provides insights into the challenges. It focuses on the increasing challenges countries like Sri Lanka face in engaging with China while managing India's growing security concerns. It also shows how geopolitical pressures constrain the policy autonomy of smaller countries when policies or decisions involve locations of strategic interest to India and China, highlighting the diplomatic and policy vulnerabilities of dependence on competing great powers.

Section 4 discusses the pitfalls. It provides insights into the hidden costs of finance, showing the importance of looking beyond loan values, interest costs and maturity periods to understand the true cost of financing. It identifies weak legal and institutional frameworks as a key vulnerability within countries like Sri Lanka that risks them squandering the opportunities discussed in Section 2 of the report.

The final section focuses on safeguards. It outlines practical actions that smaller South Asian nations can take to maximise the developmental benefits of external financing while mitigating associated risks. It shows how strengthening regulatory frameworks, enhancing oversight and institutionalising transparency and accountability measures in countries like Sri Lanka can help improve their capacity to manage future engagements with competing major powers while safeguarding their own interests.

02
Opportunity: New Sources of Finance

Sri Lanka is a South Asian country that successfully secured financial support from India and China, leveraging their interests and concerns with its own. Since 2000, India and China, once negligible financiers, have become two of Sri Lanka's primary providers of foreign loans, grants and investments. These two countries accounted for slightly over two-thirds of the total bilateral loan commitments between 2000 and 2023, with China providing 45% and India 23%.[2] Before 2000 (i.e., according to data available for 1957-1999), Sri Lanka had no borrowings from China, while loans from India constituted less than 2% of its bilateral loans. A similar pattern is observed in grants: available data from 1973 to 1999 reveal that China and India contributed only 1.2% and 0.7%, respectively, of all bilateral grants. In contrast, from 2020 to 2023, they accounted for nearly one-third of the grant contributions, with China accounting for 21% and India for 13%. India and China have also become key sources of foreign direct investment (FDI), each accounting for approximately 15% of Sri Lanka's FDI stock (refer to Annexure 1).[3]

In the first 14 years (2000 - 2014), the competition and rivalry between India and China were less visible and tense than they are now. Hence, it is fair to say that during this period, the financing decisions of these two countries were driven more by their own interests and concerns than by their competition and rivalry with each other. For instance, during this time, India did not express significant concern over China's presence in Sri Lanka, enabling the country to secure funding from both without antagonising either.

This, however, changed post-2014. The relationship between India and China became strained due to multiple factors, and its concerns over China's presence in Sri Lanka increased as the two countries elevated their relations to a strategic cooperative partnership following Rajapaksa's visit to China in 2013.[4] This visit also coincided with Sri Lanka entering into an early partnership with China's BRI, further solidifying its ties with

2. Sri Lanka's total loan commitments between 2000 and 2023 were distributed as 24% from multilateral institutions, 41% from bilateral lenders and 35% from international financial markets including ISBs

3. Author's calculations using data from the External Resources Department and Ministry of Finance

4. Ministry of Foreign Affairs, Sri Lanka, "Sri Lanka and China agree to deepen their strategic cooperative partnership", 16 September 2014 at https://mfa.gov.lk/sri-lanka-and-china-agree-to-deepen-their-strategic-cooperative-partnership/ [last accessed 15 December 2024]

China's BRI, further solidifying its ties with China. The 99-year lease of the Hambantota Port – located 10 nautical miles away from the busiest East-West sea route – in 2017 only heightened India's security concerns about China's expanding footprint in Sri Lanka. The 2020 clash between Indian and Chinese forces in the Galwan Valley further intensified tensions.[5]

These developments made Sri Lanka transition to a delicate three-way balancing act post-2014 to secure funding from both India and China. Sri Lanka had to balance its national interests while simultaneously navigating the escalating competition and rivalry between these two major powers in the region.

2.1. 2010 - 2014: China became the largest source of finance for infrastructure

The government led by President Mahinda Rajapaksa, which was in power from 2005 to 2014, was able to secure large sums of money from China to fund its ambitious infrastructure projects in the coastal Southern and Western Provinces of Sri Lanka. It did so by leveraging China's "Going Global" strategy, BRI and its heavy dependence on the Indian Ocean for energy.

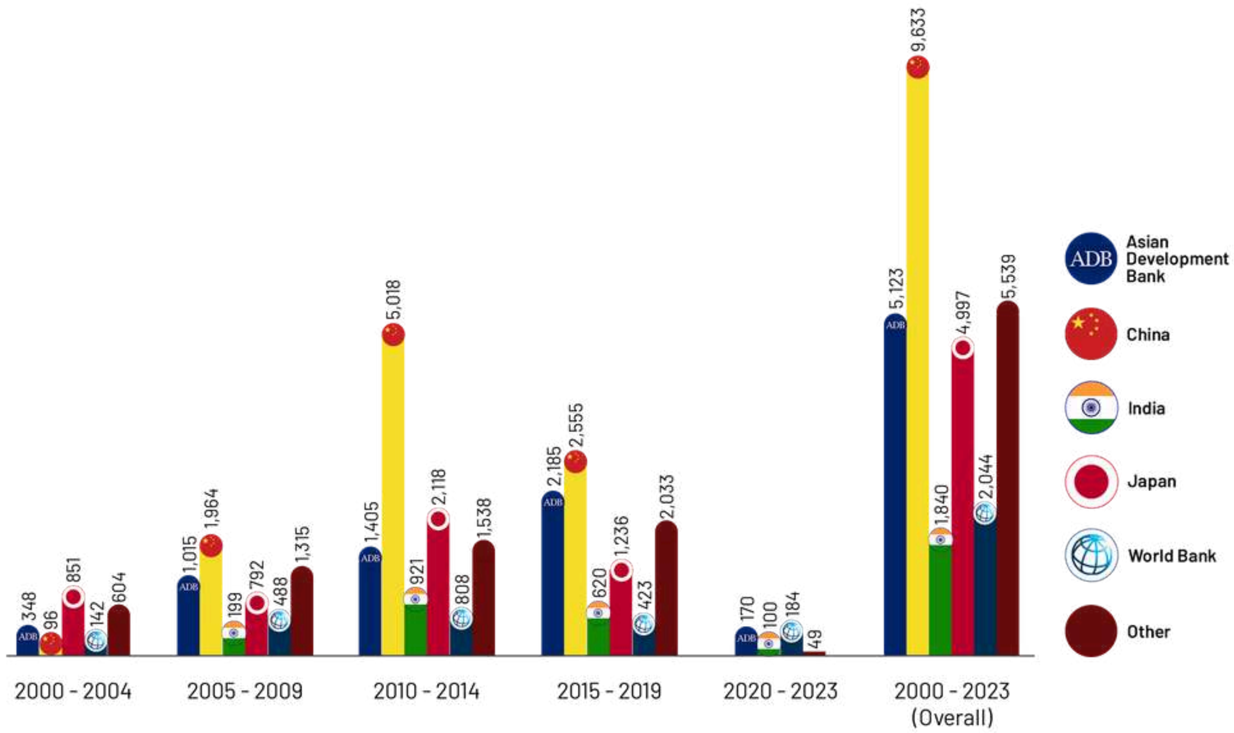
The substantial inflow of funds from China to Sri Lanka during President Mahinda Rajapaksa's tenure (2005 - 2014) illustrates how geopolitical developments created opportunities for countries like Sri Lanka to access new sources of financing.

The government accelerated its infrastructure drive immediately after the end of the three-decade-long armed conflict in 2009. The government's national development framework, the 'Mahinda Chinthana – Vision for the Future', published in 2010, prioritised large-scale infrastructure investments to capitalise on the peace dividend after the war. The framework aimed to close the 'infrastructure gap' between Sri Lanka and its neighbours through substantial investments in transport, energy, water, sanitation and irrigation.[6] As a result, from 2010 to 2014, there was a surge in infrastructure financing from all key lenders to Sri Lanka. Among them, China emerged as the largest provider of infrastructure funding (Figure 1). For example, of the USD 29 billion in foreign loans committed to finance infrastructure between 2000 and 2023, 33% (USD 9.6 billion) was provided by China. Notably, 52% of the funding from China came in between 2010 and 2014 during President Rajapaksa's second tenure.

5. Reuters, 'What was the India China Military Clash in 2020 about?', 25 October 2024, at https://www.reuters.com/world/asia-pacific/what-was-india-china-military-clash-2020-about-2024-10-25/ [last accessed 12 December 2024]

6. Department of National Planning, Ministry of Finance and Planning, Mahinda Chinthana, A Vision for New Sri Lanka, Ten year development plan (2006), at https://www.thegef.org/sites/default/files/ncsa-documents/MahindaChintanaTenYearDevelopmentPlan.pdf [last accessed 18 November 2024]; Department of National Planning, Ministry of Finance and Planning, Mahinda Chinthana, Vision for the Future (2010), at https://faolex.fao.org/docs/pdf/srl170008.pdf [last accessed 18 November 2024].

Figure 1:
Infrastructure loan commitments by period and source of finance* (in USD Mn)

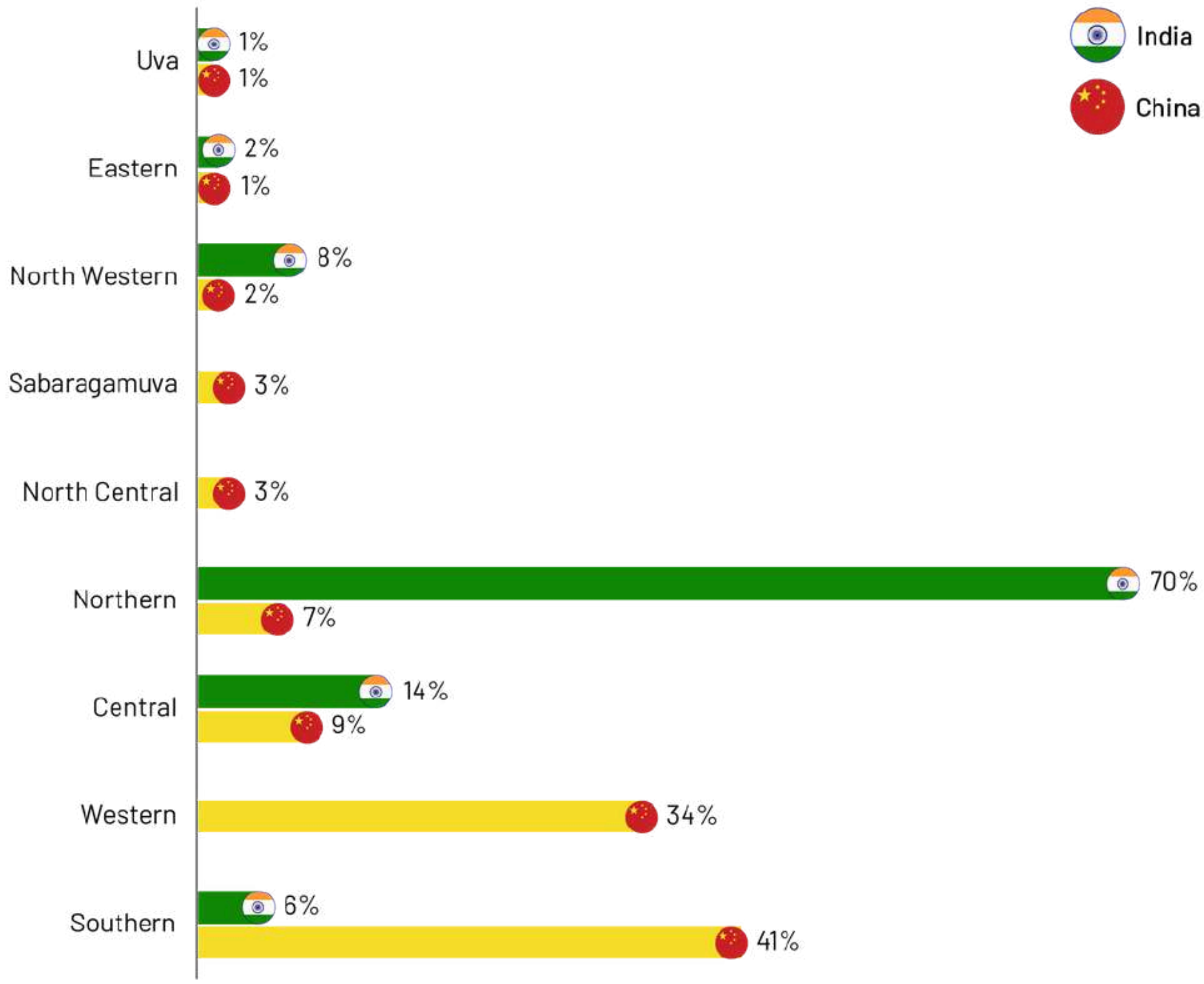


*International financial market borrowing such as International Sovereign Bonds (ISBs) have been excluded from this assessment.

Source: Author's calculations using data from the External Resources Department, Ministry of Finance

As shown in Figure 2, the lion's share (75%) of the funds from China during 2010 - 2014 was earmarked for infrastructure projects in the coastal Southern and Western Provinces, both strategically located near the East-West shipping lane. The Southern Province, including Hambantota, Mahinda Rajapaksa's hometown, received the highest share of infrastructure financing from China during this period, accounting for 41% of the total.

Figure 2:
Geographical distribution of finance from India and China by province for the period 2010-2014* (as a % of the total received during the period for each country)



*Includes loan and grant commitments as well as strategic investments that took place during this period

Source: Author's calculations using data from the External Resources Department, Ministry of Finance, BOI, Port City, and SDP Act gazettes

The government's development plan for the Southern Province was called the "Ruhuna Udanaya" or "Awakening of the South" programme. It was an initiative aimed at diversifying economic activities by reducing the heavy concentration on Colombo.[7] The government infrastructure development plan for the Southern Province aimed to bridge the province's infrastructure gaps. The plan included a new seaport, an international airport, an industrial zone, expressways, a convention centre, an international cricket stadium and tourist resorts.[8] The Western Province received the second-largest portion of financing from China

7. Department of National Planning, Ministry of Finance and Planning, Mahinda Chinthana, A Vision for New Sri Lanka, Ten year development plan (2006), at https://www.thegef.org/sites/default/files/ncsa-documents/MahindaChintanaTenYearDevelopmentPlan.pdf [last accessed 18 November 2024]

8. Department of National Planning, Ministry of Finance and Planning, Mahinda Chinthana, Vision for the Future (2010), at https://faolex.fao.org/docs/pdf/srl170008.pdf [last accessed 18 November 2024].

for infrastructure development. The government wanted to make the Western Province the premier commercial hub in South Asia with world-class infrastructure.[9] (refer to Annexure 2)

The Sri Lankan government's ambitious plans for the Southern and Western Provinces, strategically located near the East-West shipping lane, aligned well with two key policy initiatives of China. The first was China's "Going Global" policy in the late 1990s, when Chinese SOEs were encouraged to venture outside the country to create alternate markets.[10] The second was China's BRI, a "massive infrastructure project that aims to connect multiple continents across land and sea."[11] Central to these policies was also the 'Malacca Dilemma'—the fear of a naval blockade in the Malacca Strait, through which over 70% of China's oil and LNG imports pass. This explains much of China's push to safeguard its maritime lines of communication in the region.[12] A key reason for China's expanding footprint in the Indian Ocean region is to secure strategic locations critical to its energy security.[13]

The alignment of mutual interests between Colombo and Beijing was strengthened in 2013 when the two nations upgraded their bilateral relations to a strategic cooperative partnership following President Mahinda Rajapaksa's visit to China. This partnership was further solidified in 2014 with President Xi Jinping's reciprocal visit to Colombo.[14] Several high-profile projects were launched in Sri Lanka shortly after the upgrading of bilateral relations and the official announcement of the BRI. These include the Colombo Port City launched in November 2013 and the Southern expressway and outer circular highway expansion from Kerawalapitiya to Kadawatha in 2014. These initiatives marked 2014 as the year with the highest annual influx of infrastructure funds from China into Sri Lanka.

However, it is important to note that China's engagement with Sri Lanka's infrastructure predated the BRI, with significant projects already progressing well before the initiative's announcement. Notable examples include the Norochcholai Coal Power Plant (2005) and a USD 1.2 billion investment in the Hambantota Port (starting in 2007). The development of the Katunayake Expressway and Mattala Airport followed in 2009 and 2010, respectively. Overall, 41% of China's infrastructure funding to Sri Lanka was allocated between 2000 and September 2013, before the official launch of the BRI.

9. *ibid*

10. Hongying Wang, 'A Deeper Look at China's "Going Out" Policy', March 2016, at https://www.cigionline.org/static/documents/hongying_wang_mar2016_web.pdf [last accessed 18 November 2024].

11. Spencer Feingold, World Economic Forum, 'China's Belt and Road Initiative turns 10. Here's What to Know', 20 November 2023, at https://www.weforum.org/stories/2023/11/china-belt-road-initiative-trade-bri-silk-road/ [last accessed 18 November 2024].

12. Indo-Pacific Defense Forum, "Malacca Dilemma' drives PRC policies, aggression', 28 November 2023, at https://ipdefenseforum.com/2023/11/malacca-dilemma-drives-prc-policies-aggression/ [last accessed 18 November 2024].

13. Austin Strange, Chinese Global Infrastructure (Cambridge University Press, 2023).

14. Ministry of Foreign Affairs, Sri Lanka, "Sri Lanka and China agree to deepen their strategic cooperative partnership", 16 September 2014 at https://mfa.gov.lk/sri-lanka-and-china-agree-to-deepen-their-strategic-cooperative-partnership/ [last accessed 15 December 2024].

Interestingly, the analysis also reveals that many projects implemented with funding from China during the Mahinda Rajapaksa period were conceptualised or initiated long before he came into power. For example, projects like the Norochcholai Coal Power Plant, the airport expressway and the Southern Expressway date back to the 1980s and 1990s. The Hambantota Port was first mentioned in a 1997 feasibility study (refer to Annexure 3). Financial constraints and a high defence budget forced previous governments to delay these projects.

2.2. 2010 - 2014: India became the leading provider of funds to rebuild the North

The proximity of the Northern Province to India's Southern coast, combined with India's historical, religious and ethnic ties to the Tamil community living there, led to increased financial assistance from India to reconstruct the war-torn infrastructure in the North. The Northern Province is separated from India by the Palk Strait and the Gulf of Mannar, a narrow sea channel approximately 50 km wide, making it critical for India's national security.

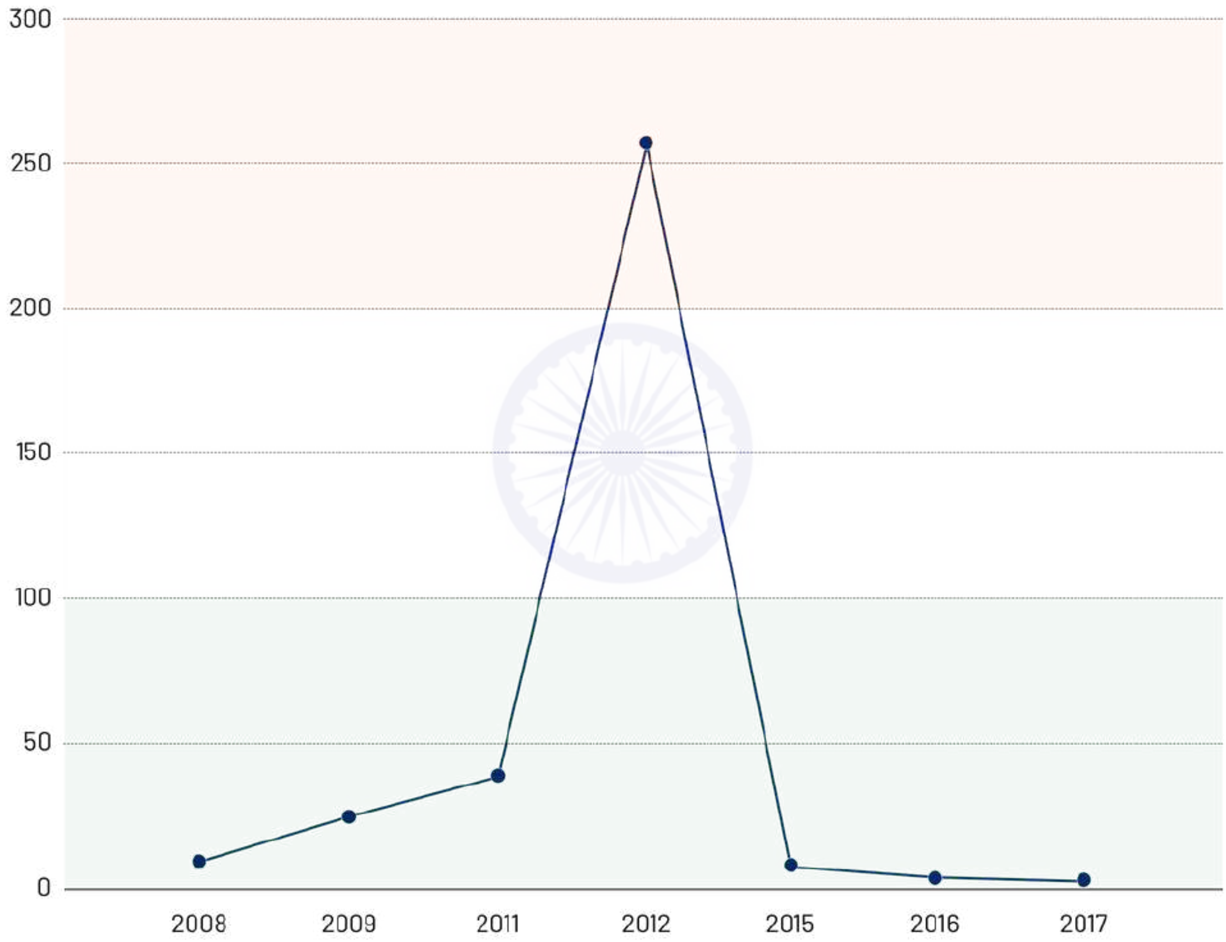
Of the total financing for infrastructure received from India since 2000, 47% came in immediately after the end of the armed conflict in 2009, and 70% of that was earmarked to rebuild the infrastructure in the Northern Province[15] (Figure 2). The Central Province received the second-largest share of financing from India (14%) toward infrastructure development. The Central Province is also home to the Indian-Origin Tamil community, one of the most marginalised communities in the country.

A separate look at the timing and geographical distribution of official grant commitments from India reflects the Indian government's close ties to these provinces. Since 2000, 76% of the grants received from India have been directed to the Northern Province, 12% to the Eastern Province and 6% to the Central Province.

Notably, 93% of India's official grant commitments were made from 2009 to 2012, after the end of the armed conflict. The grants peaked in 2012 with a flagship grant of USD 257 million for 49,000 housing units in the Northern, Eastern, Central, and Uva Provinces for internally displaced persons (IDPs). Of these housing units, 40,675 were allocated to the Northern Province and 4,160 to the Eastern Province (Figure 3).

15. The armed conflict between the Liberation Tigers of Tamil Eelam (LTTE), a militant organisation, and the Sri Lankan government's armed forces took place largely in the Northern and Eastern Provinces of Sri Lanka, where the LTTE sought to establish an independent Tamil state.

Figure 3:
Grant Commitments from India (USD Mn)*



*Although India has provided various grants through unofficial channels since 2017, the External Resources Department (ERD) has not recorded any official grants from India to the Sri Lankan government during this period.

Source: Author's calculations using data from the External Resources Department, Ministry of Finance

This assistance aligned well with the Sri Lankan government's infrastructure development programme in the North, the "Uthuru Wasanthaya"/"Vadakkin Wasantham" programme. It aimed to accelerate development efforts to promote national unity and reconciliation by rebuilding the Northern region of Sri Lanka.

Such geographical earmarking of these funds suggests that Sri Lanka leveraged India's strategic interest in the Northern Province and its ethnic affinities to secure the finance necessary to reconstruct Northern infrastructure. India appears to have leveraged its ties to the region and Sri Lanka's need for funding to secure a locus standi or pressure point in Sri Lanka that was in tune with its interests as a rising power—regionally and globally.[16]

16. Key Informant Interview with a retired senior government diplomat conducted on 30 November 2024.

2.3. 2015 – 2019: China became the largest source of non-infrastructure finance

After President Mahinda Rajapaksa's electoral defeat in 2015, Sri Lanka experienced a surge in non-infrastructure financing from China. This was in a bid to forge closer ties with the new coalition government, which appeared to have a less favourable view of projects funded by China.

During its election campaign, the coalition government that assumed office in 2015 was highly critical of projects funded by China, particularly the Colombo Port City. For instance, it temporarily suspended the Port City project after taking office, citing concerns over its potential negative environmental impacts.[17] During the campaign, they pledged to cancel infrastructure projects that bypassed due process and sought to halt all projects that had originated as unsolicited proposals (USPs) during the previous government, most of which were funded by China.[18]

Further, the new government prioritised fiscal consolidation over infrastructure development. Consequently, a larger share of financing was allocated to non-infrastructure initiatives compared to earlier periods (Figure 4). Non-infrastructure financing – covering general credit lines, in-kind donations of goods and other technical assistance programmes – has grown significantly since 2015. The composition of this funding also showed a more balanced distribution among key sources of finance than before (Figure 5).

The new coalition government also pledged to adopt a more balanced foreign policy. Experts particularly noted a post-2015 focus on renewing strained relations with India.[19] This shift was evident when President Maithripala Sirisena and Prime Minister Ranil Wickremesinghe chose India for their first official overseas visits after assuming office in January and September 2015 respectively. It is also noteworthy that Indian Prime Minister Narendra Modi, who visited Sri Lanka in March 2015, became the first Indian leader in three decades to visit the country.[20]

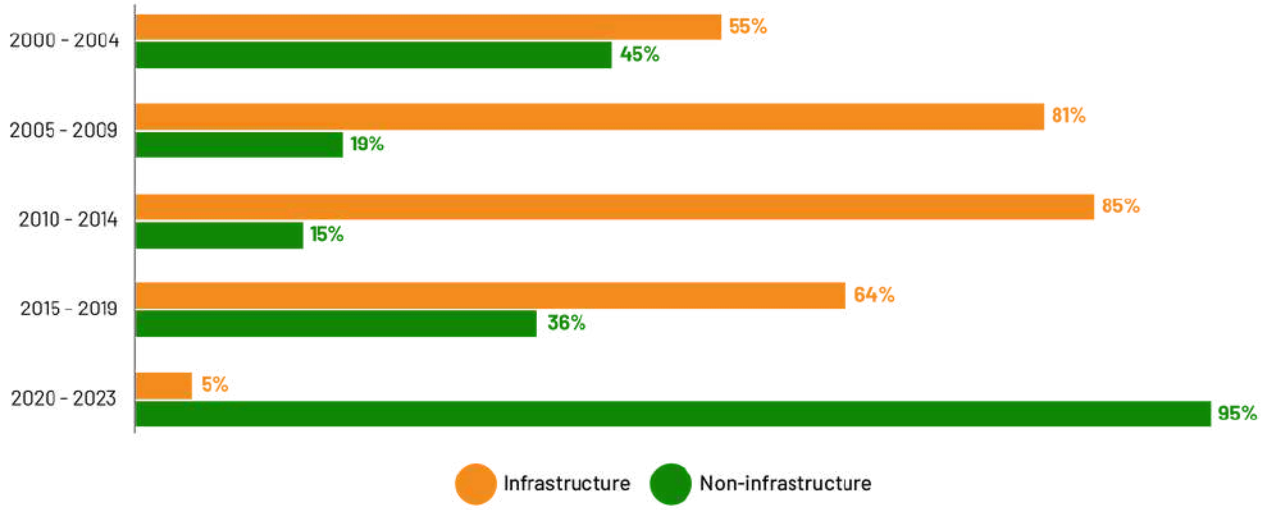
17. Ada Derana, 'Colombo Port City Project Suspended', 6 March 2015, at https://adaderana.lk/news.php?nid=30018 [last accessed 18 November 2024].

18. Verité Research, 'The Lure of Chinese Loans', August 2022, at https://www.veriteresearch.org/wp-content/uploads/2022/08/VR_EN_RR_Aug2022_The-Lure-of-Chinese-Loans.pdf [last accessed 18 November 2024].

19. Geethanjali Nataraj and Richa Sekhani, 'A New Era for India-Sri Lanka Relations', 7 March 2015, at https://eastasiaforum.org/2015/03/07/a-new-era-for-india-sri-lanka-relations/ [last accessed 12 December 2024].

20. DW, 'Indian PM Modi looking to mend ties in historic visit to Sri Lanka', 13 March 2015, at https://www.dw.com/en/indian-pm-modi-looking-to-mend-ties-in-historic-visit-to-sri-lanka/a-18313419 [last accessed 18 November 2024].

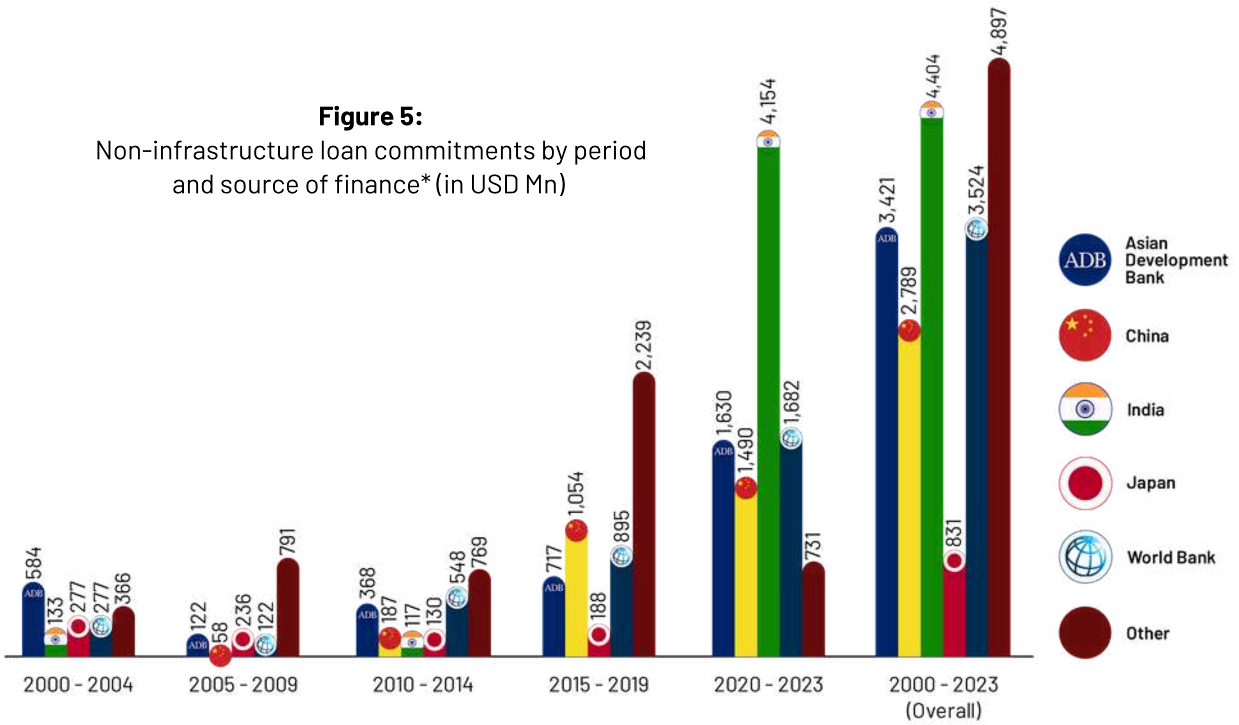
Figure 4:
Breakdown of total financing from all sources for infrastructure and non-infrastructure*
(as a % of loan commitments)



*International financial market borrowing such as International Sovereign Bonds (ISBs) have been excluded from this assessment.

Source: Author's calculations using data from the External Resources Department, Ministry of Finance, BOI, Port City and SDP Act gazettes

Figure 5:
Non-infrastructure loan commitments by period and source of finance* (in USD Mn)

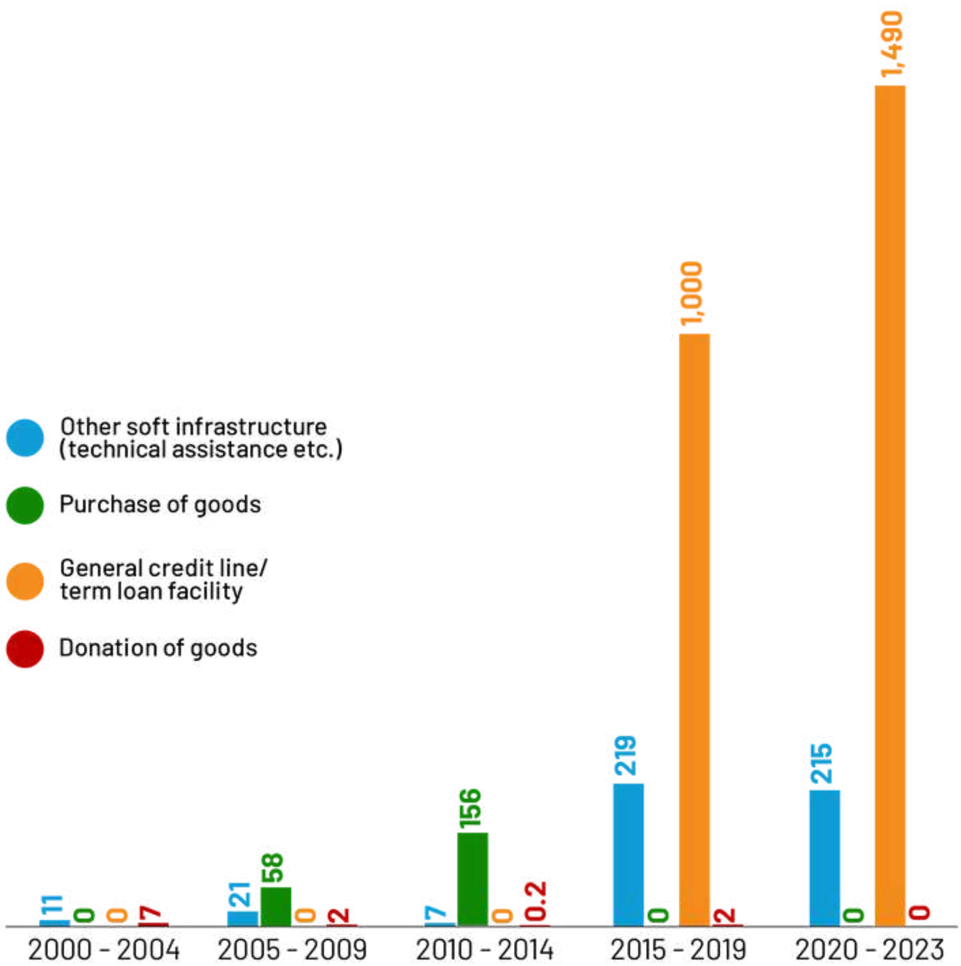


*International financial market borrowing such as International Sovereign Bonds (ISBs) have been excluded from this assessment.

Source: Author's calculations using data from the External Resources Department, Ministry of Finance, BOI, Port City and SDP Act gazettes

Amid these developments, China appears to have sought to regain its waning influence in Sri Lanka by aligning its financial assistance with the new government's priorities. China stepped outside its usual modus operandi to strengthen ties with the new government by significantly increasing its non-infrastructure financing to Sri Lanka. For instance, while China's total infrastructure loan commitments decreased by 61% compared to 2010 – 2014, the non-infrastructure funding rose significantly from LKR 164 million in 2010 – 2014 to LKR 1,221 million during 2015 – 2019. China became the largest source of non-infrastructure financing during this period. General foreign currency term-loan facilities comprised a significant portion of China's non-infrastructure funding (Figure 6). China continued to extend non-infrastructure financing during 2020 – 2023 as well. Since 2015, Sri Lanka has obtained over USD 2.3 billion in foreign currency term-loans from China, with USD 1.3 billion disbursed during the 2020 – 2023 economic crisis.

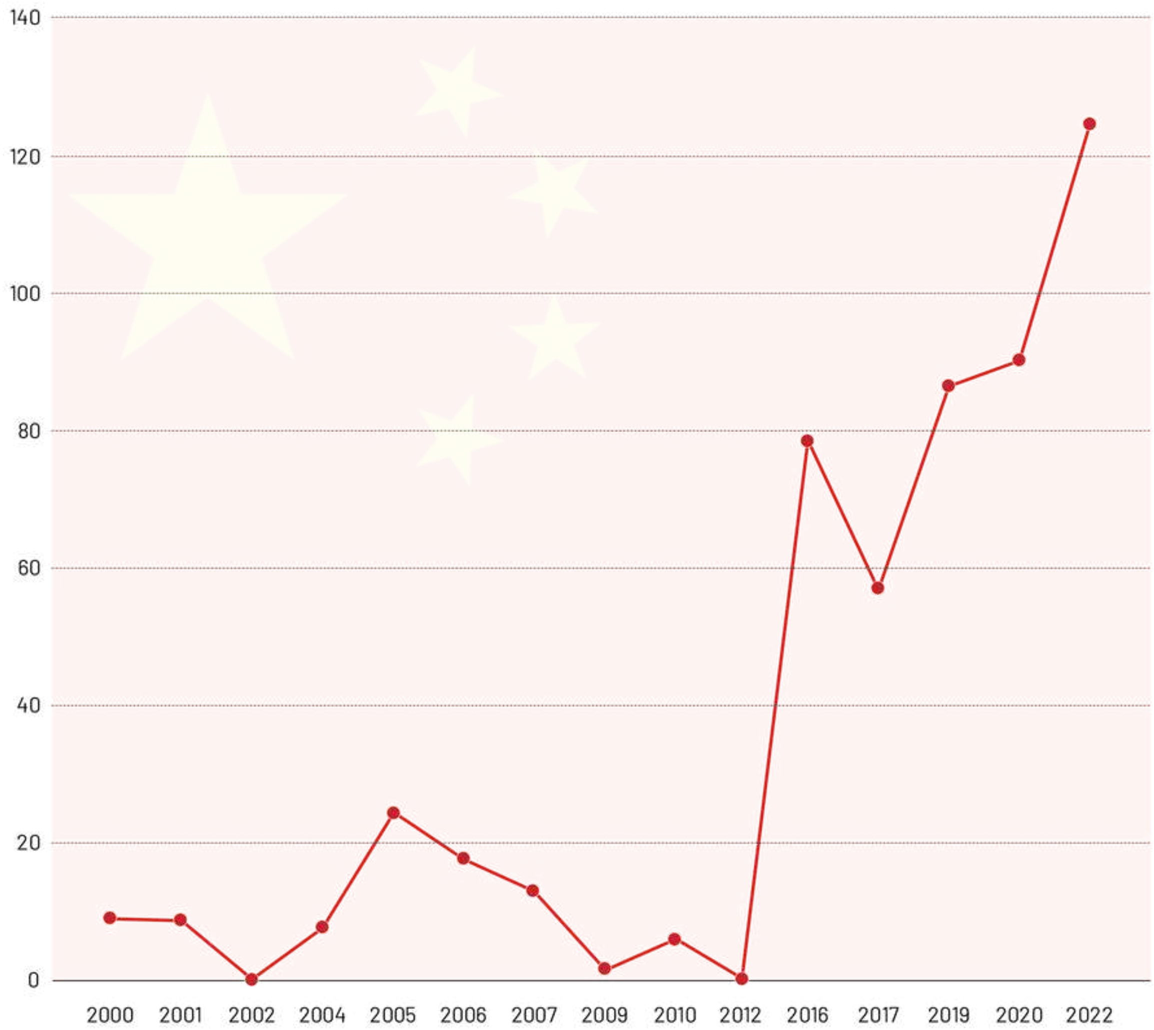
Figure 6:
Distribution of non-infrastructure financing from China* by period and by type of financing (USD Mn)



*China's economic and technical cooperation grants have been classified as non-infrastructure in this analysis, yet there may be infrastructure elements in them. However, this information is not publicly available.

Source: Author's calculations using data from the External Resources Department, Ministry of Finance, BOI, Port City and SDP Act gazettes

Figure 7:
Grant commitments from China (USD Mn)



Source: Author's calculations using data from the External Resources Department, Ministry of Finance, BOI, Port City and SDP Act gazettes

The government later relaxed its stance on suspending projects, and proceeded with those already committed to, following the recommendation of the Cabinet Committee on Economic Management (CCEM).[21] Interviews with senior government officials and Verité Research's findings revealed that infrastructure loans from China recorded during this period were primarily allocated to projects initiated or contracts signed before 2015.[22]

21 Ministry of Finance and Mass Media, Sri Lanka, 'Note to the Cabinet: Gampaha Attanagalla, Minuwangoda Integrated Water Supply Project', 21 May 2018.

22 Key Informant Interview with a retired senior government official conducted on 24 September 2024; Verité Research, 'The Lure of Chinese Loans', August 2022, at https://www.veriteresearch.org/wp-content/uploads/2022/08/VR_EN_RR_Aug2022_The-Lure-of-Chinese-Loans.pdf [last accessed 18 November 2024].

Beyond the legal repercussions of nullifying the contracts, China's generosity towards the new government may have also helped soften its stance towards projects financed by China. In 2015, President Xi Jinping invited President Maithripala Sirisena to visit China to rekindle bilateral relations. During this visit China pledged several grants to Sri Lanka, including funding for a fully-fledged modern hospital for kidney patients in Polonnaruwa, President Sirisena's hometown, which has a high incidence of chronic kidney disease (CKD).[23] The Sri Lankan media extensively covered President Sirisena's visit to China, highlighting China's commitment to supporting Sri Lanka's development efforts.[24] China's generosity during this period is evident in the sharp increase in grant commitments after 2016. Notably, 82% of all grants committed by China since 2000 were committed between 2016 and 2022 (Figure 7).

2.4. Post-2020: India became the largest source of finance

India's emergence as the largest source of bilateral finance to Sri Lanka post-2020 to meet Sri Lanka's critical financial needs reflects India's intent to outmanoeuvre China in the South Asian region. This trend also shows how the growing competition for influence in the region between China and India post-Galwan resulted in increased financial flows to countries like Sri Lanka.

This intent is illustrated in the statement of India's Minister of External Affairs S. Jaishankar: "The answer is not to complain about what China is doing. The answer is, okay, you are doing it. Let me do better." [25] Thus, Sri Lanka appears to have benefitted from this renewed Indian interest in Sri Lanka. India's non-infrastructure financing surged from just USD 378 million between 2000 and 2019 to USD 4 billion during 2020 - 2023. In other words, 91% of India's total non-infrastructure funding to Sri Lanka occurred during 2020 - 2023, when Sri Lanka was grappling with its worst economic crisis since independence.[26] This financing provided critical budget support to address the acute shortage of essential commodities, including petroleum and fertiliser (Figure 8).

23. Ministry of Foreign Affairs, Sri Lanka, 'President Maithripala Sirisena Undertakes Successful State Visit to the People's Republic of China', 27 March 2015, at https://mfa.gov.lk/president-maithripala-sirisena-undertakes-successful-state-visit-to-the-peoples-republic-of-china/ [last accessed 18 November 2024].

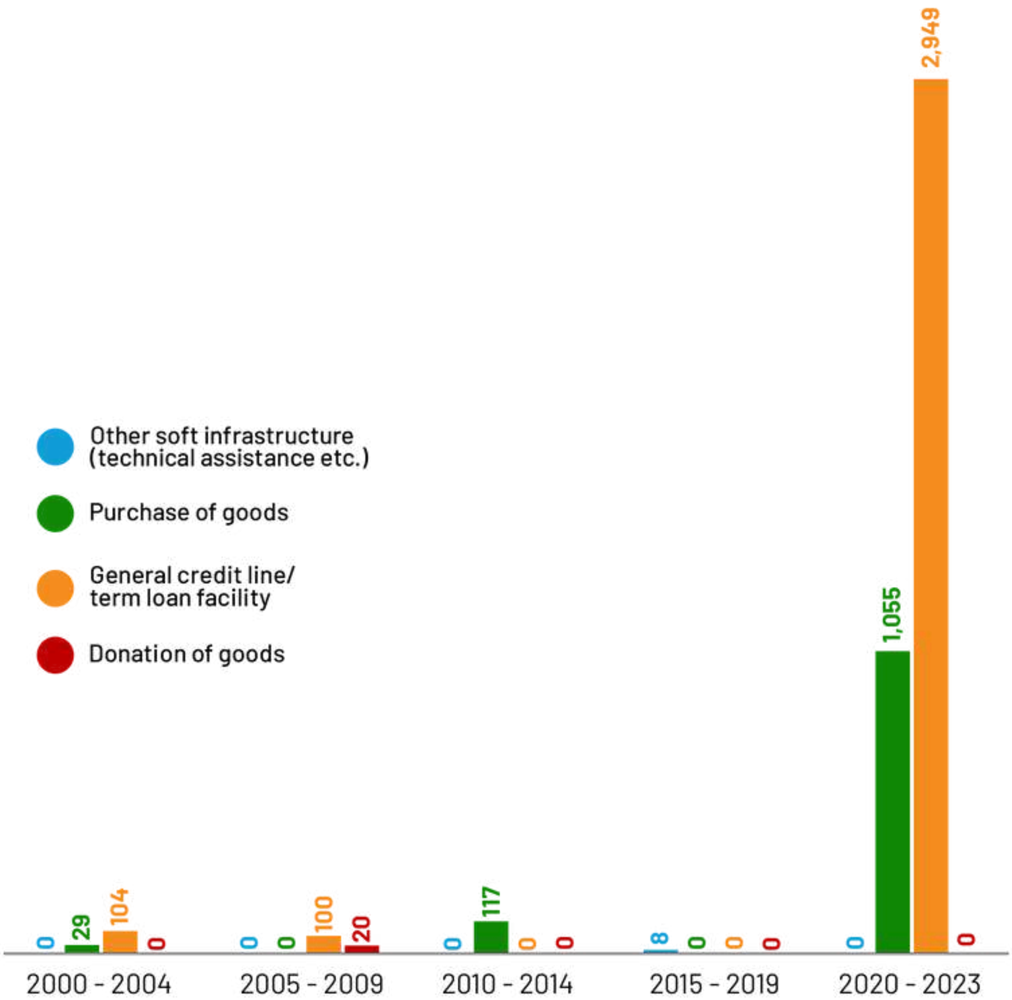
24. Verité Research, National Media Portrayal of China in Sri Lanka – A Case Study of Colombo Port City and Hambantota Port (December 2019).

25. The Times of India, "I don't think we should be scared of China, rather .....": EAM Jaishankar", 30 January 2024, at https://timesofindia.indiatimes.com/india/i-dont-think-we-should-be-scared-of-china-rather-eam-jaishankar/articleshow/107260144.cms [last accessed 15th December 2024].

26. Sri Lanka underwent multiple crises during 2019-2022. In 2019, the Sri Lankan capital was shaken by the Easter Sunday terrorist attacks. As the country was about to recover from this crisis, it had to tackle the COVID-19 pandemic in 2020. The impact of these shocks, coupled with several policy blunders made by the government, led the country into a balance-of-payment crisis in 2021. With official foreign reserves dwindling to a level that is insufficient even to meet one month's expenditure on imports, the government struggled to provide its citizens with the most essential imported products such as fuel, gas, and medicine or service its foreign debt. On 12th April 2022, the Sri Lankan government announced that it was suspending its foreign debt payments. This is the first time the country has defaulted on its debt.

On certain occasions, India's assistance was indicative of its competition with China. According to Rup Narayan Das, for example, the timing of India's provision of 100 kgs of nano-nitrogen to Sri Lanka in 2021 in the middle of a row between China and Sri Lanka over the supply of contaminated fertiliser was a clever and swift diplomatic move by India.[27]

Figure 8:
Distribution of non-infrastructure financing from India by period and by type of financing (USD Mn)



Source: Author's calculations using data from the External Resources Department, Ministry of Finance, BOI, Port City and SDP Act gazettes

An increase in finance in the form of investments from India into strategic sectors such as energy and ports in Sri Lanka post-2020 reflects India's renewed interest in containing China's influence at strategic locations in South Asia. Sri Lanka appears to have leveraged India's interests and concerns to attract investments to Sri Lanka.

27. Rup Narayan Das, 'Sri Lanka's Balancing Act Between China and India', China Brief Volume: 21 Issue: 23, 3 December 2021, at https://jamestown.org/program/sri-lankas-balancing-act-between-china-and-india/ [last accessed 18 November 2024].

Since 2015, India has been looking beyond Sri Lanka's Northern Province. It has shifted its focus to other strategic locations in Sri Lanka, particularly Colombo and Hambantota in the Western and Southern Province respectively.[28]

India, which was somewhat reluctant to invest in Sri Lanka's port sector in the past to avoid bolstering a regional competitor, appears to have changed this stance in recent years.[29] Growing concerns over China's substantial investments in Sri Lankan ports – such as the Colombo International Container Terminals Limited (CICT) in 2014 and the Hambantota Port lease in 2017 – prompted India to reassess its perception of Sri Lanka as a competitor in port operations. The slowdown in funding from China after 2015, growing criticism of China-funded projects and the new government's desire to adopt a more balanced foreign policy posture created an opportunity for India to enhance its engagement with Sri Lanka.

These developments ultimately led to Indian engagement intensifying significantly after 2020, with 67% of India's total funding to Sri Lanka since 2000 occurring between 2020 and 2023. In contrast to China, where 100% of finance during the crisis period was earmarked to meet non-infrastructure financial needs, India continued to finance infrastructure primarily through PPPs, with 14% of the funds being earmarked for infrastructure.

A key challenge faced by India in countering China was its inability to match China's infrastructure funding capacity and its lack of SOEs comparable to China's, which could invest extensively on a global scale. However, recent actions by New Delhi indicate its attempt to counter Beijing by leveraging the rise of large private Indian conglomerates such as the Adani Group. These Indian companies have, over the years, developed their capacity and expertise and are actively seeking investment opportunities abroad.

Capitalising on these developments, companies like the Adani Group have begun actively engaging in strategic sectors such as ports and energy in Sri Lanka. These investments seem mutually beneficial for the Indian private sector and government. They have aligned private commercial interests with the government's strategic goals to contain China's expansion in the region. The Sri Lankan government's treatment of Adani projects in energy and ports is a testament to this alignment. Although they were PPPs, the Sri Lankan government treated them as government-to-government (G2G) agreements.[30] According to Sri Lanka's then Foreign Minister Ali Sabry, it is the Indian government that identified the Adani Group to invest in infrastructure projects in Sri Lanka.[31]

28. The Indian Ministry of External Affairs (MEA) statement on the "Neighbourhood First" policy is as follows: "It is time that India should accelerate its own connectivity projects under various initiatives such as the 'Act East' policy, 'Neighbourhood First' policy, 'Go West' strategy and the 'Spice Route', as a counter to the narrative of the BRI, which has gained some currency in our neighbourhood. It is high time to showcase a more just, equitable and user-friendly developmental assistance model to countries lured by the BRI without realising its far-reaching consequences" (MEA, 2018).

29. Key Informant Interview with an international relations expert conducted on 23 September 2024.

30. Suhasini Haidar, 'Sri Lankan Foreign Minister Ali Sabry is Confident that India's Adani Group's Current Financial Crisis will not Affect its Envisaged Projects in Sri Lanka - Interview with Suhasini Haidar of "The Hindu"', 8 March 2023, at https://dbsjeyaraj.com/dbsj/?p=81520 [last accessed 18 November 2024].

31. *ibid*.

The statements made by the then chairperson of the Ceylon Electricity Board (CEB) as well as the then foreign minister of Sri Lanka suggest that the Sri Lankan government was attempting to leverage India's renewed interest to bring in additional investments. For example, in a letter to the secretary of the Treasury, then chairperson of the CEB explained that President Gotabaya Rajapaksa directed him to facilitate the Adani Green Energy 500 MW project, as the Adani Group had already committed to a significant FDI in Sri Lanka.[32] This sentiment was reinforced by the then Foreign Minister Ali Sabry, who, in a March 2023 interview with Indian media, expressed that Sri Lanka "hopes for more Indian investment in the next phase of its economic recovery."[33]

Indian investors are also collaborating with firms and lenders from other countries interested in the Indian Ocean region to raise the necessary funds for investment. For example, in 2019, Sri Lanka signed a Memorandum of Cooperation (MoC) with India and Japan to develop the East Container Terminal in the Colombo Port.[34] While this agreement failed to materialise, India received a consolation prize in the form of the Adani Colombo West International Container Terminal.[35]

The increased competition between India and China at the Colombo Port is also evident from their proposed investments in logistics parks. China Merchant Port announced plans to invest in a logistics park in the Colombo Port in 2023. Similarly, the Adani Group formally requested space to establish a logistics centre in 2024.[36]

32. Chandani Kirinde, Daily FT, 'Ferdinando appears before COPE, more questions than answers on Adani project', 24 June 2022, at https://www.ft.lk/front-page/Ferdinando-appears-before-COPE-more-questions-than-answers-on-Adani-project/44-736571 [last accessed 18 November 2024].

33. Suhasini Haidar, 'Sri Lankan Foreign Minister Ali Sabry is Confident that India's Adani Group's Current Financial Crisis will not Affect its Envisaged Projects in Sri Lanka - Interview with Suhasini Haidar of "The Hindu"', 8 March 2023, at https://dbsjeyaraj.com/dbsj/?p=81520 [last accessed 18 November 2024].

34. Daily FT, SL, 'India and Japan sign MoC to develop ECT', 29 May 2019, at https://www.ft.lk/front-page/SL--India-and-Japan-sign-MoC-to-develop-ECT/44-679094 [last accessed 18 November 2024].

35. Colombo West International Terminal Pvt. Ltd. is a consortium comprising India's largest port operator Adani Ports and SEZ Ltd, Sri Lankan conglomerate John Keells Holdings and Sri Lanka Ports Authority.

36. Ishara Gamage, Ceylon Today, 'India's Adani Group Plans Logistics Centre in Colombo Port', 29 February 2024, at https://ceylontoday.lk/2024/02/29/indias-adani-group-plans-logistics-centre-in-colombo-port/ [last accessed 18 November 2024].

The bid by M/s Shaurya Aeronautics (Pvt.) Ltd from India and the "Airports of Regions Management Company" from Russia to jointly manage the Mattala Airport for 30 years highlights India's interest in getting a foothold in the Southern Province.[37] The Mattala Airport, located in the Hambantota District and often referred to as the "world's emptiest airport", was built with loans from China.[38] Of the five bids received, Sri Lanka's cabinet of ministers selected the Indian and Russian joint venture in April 2024.[39] Recent reports, however, suggest that this deal may not proceed as planned due to legal hurdles in Sri Lanka and complications arising from Shaurya Aeronautics (Pvt.) Ltd facing U.S. sanctions over its business dealings with Russia.[40]

India has also increased its energy and port engagement within the Northern Province. In addition to Adani Green Energy's 250 MW Mannar Wind Power Project investment in 2023, India has expressed interest in leasing the Kankesanthurai (KKS) Harbour for 30 years.[41]

37. Zulfick Farzan, News First, 'Cabinet Nod For Russia, Indian Management For Mattala International Airport', 26 April 2024, at https://www.newsfirst.lk/2024/04/26/cabinet-nod-for-russia-indian-management-for-mattala-international-airport [last accessed 18 November 2024].

38. Brook Larmer, The New York Times, 'What the World's Emptiest International Airport Says About China's Influence', 13 September 2017, at https://www.nytimes.com/2017/09/13/magazine/what-the-worlds-emptiest-international-airport-says-about-chinas-influence.html [last accessed 18 November 2024].

39. Zulfick Farzan, News First, 'Cabinet Nod For Russia, Indian Management For Mattala International Airport', 26 April 2024, at https://www.newsfirst.lk/2024/04/26/cabinet-nod-for-russia-indian-management-for-mattala-international-airport [last accessed 18 November 2024].

40. Sahan Tennekoon, The Morning, 'Mattala Airport: Indo-Russo venture 'unlikely': Min.', 12 November 2024, at https://www.themorning.lk/articles/vy1fZuk7ga7XcTxxB3uo [last accessed 18 November 2024].

41. Kelum Bandara, Daily Mirror, 'India seeks to operate KKS Port for 30 years: Official', 6 August 2024, at https://www.dailymirror.lk/breaking-news/India-seeks-to-operate-KKS-Port-for-30-years-Official/108-288850 [last accessed 18 November 2024].

03
Challenges: Managing Security Concerns & Policy Constraints

A key challenge faced by South Asian countries like Sri Lanka is managing India's growing concern over China's expanding footprint in the region. As mentioned above, India views China's increased presence and growing clout in South Asia as a threat to its sovereignty and security interests and a challenge to its regional dominance. Sri Lanka's strategic location in the Indian Ocean near main shipping lanes and its proximity to India makes it particularly vulnerable to these concerns.

Former Indian Foreign Secretary and National Security Advisor Shiv Shankar Menon, in his 2016 book Choices, described Sri Lanka as an "unsinkable aircraft carrier" near India's Southern coast. This characterisation underscores India's national security concerns about the potential military use of island nations like Sri Lanka.[42]

Sri Lanka's experience reveals the adversities faced by smaller nations seeking funding from rival powers. Sri Lanka's proximity to India's Southern coast heightens India's sensitivity to Chinese activities on the island. Similar concerns apply to other South Asian nations bordering India and engaging with China.

3.1. Limiting China's presence at locations of strategic interest to India

A statement made by a former foreign secretary of Sri Lanka in a TV interview in 2020 highlighted Sri Lanka's intent to address India's security concerns over the Sri Lankan government's close relationship with China.[43] He stated that Sri Lanka follows an 'India First' policy and emphasised that "Sri Lanka cannot be a security threat to India."

42. Siddharth Varadarajan, 'India-Lanka-China Relations: The Growing Strategic Competition and the LTTE Factor', 29 December 2016, at https://thewire.in/diplomacy/india-lanka-china-menon-ltte [last accessed 18 November 2024].

43. StratNewsGlobal. 'We have an India First Policy on Strategic Security: Sri Lankan Foreign Secretary', 24 August 2020, at https://stratnewsglobal.com/sri-lanka/we-have-an-india-first-policy-on-strategic-security-sri-lankan-foreign-secretary/ [last accessed 12 December 2024].

Sri Lanka's Northern Province serves as a key example of India's security concerns. Located just 50 km across the Palk Strait and the Gulf of Mannar, the Northern Province's proximity to India underscores its strategic significance. Proximity to India has established Northern Province as a red line in India's strategic considerations regarding Sri Lanka. Additionally, India has historical, ethnic and religious ties with the Tamil population in the Northern Province.[44]

Aditya Gowdara Shivamurthy of the Observer Research Foundation (ORF) notes that Delhi expects Sri Lankan governments to respect its 'redlines', "namely, limiting Chinese engagements in defence and security cooperation and its presence in the Tamil-dominated regions."[45] The Northern Province, where over 90% of the population is Tamil, is the province that has the highest concentration of Tamil people in Sri Lanka.[46]

The limited participation of financing from China in the Northern Province infrastructure development or reconstruction reflects Sri Lanka's attempts to balance India's geopolitical sensitivities regarding Chinese involvement in the region. Although China was the largest source of financing immediately after the war's end (between 2010 and 2014), little of that funding was allocated to reconstruct the war-torn infrastructure in the Northern Province. Between 2000 and 2023, only 4% of the infrastructure funds that came in as loans, grants or strategic investments from China were directed to the Northern Province (Figure 9).

3.2. Managing China's newfound interest in the Northern Province

Limiting China's presence in the Northern Province from 2005 to 2014 is likely to have been easier for the Sri Lankan government due to two factors. First, as mentioned in the previous section, the relationship between India and China – although tense – was not as fraught as it has been since the intensification of Indian and Chinese relations post-2015, in particular after the clash of Indian and Chinese troops in the Galwan Valley in 2020.[47] Second, the Chinese strategic interests at the time appear to have been heavily focused on getting a foothold in locations closer to the East-West shipping lanes.

44. Sinhalese comprise 75% of the population in Sri Lanka, Tamils 15%, Sri Lanka Moors 9% and other ethnic groups 1%.

45. Aditya Gowdara Shivamurthy, Observer Research Foundation, 'Sri Lanka Presidential Elections: Challenges and Opportunities for India', 27 August 2024, at https://www.orfonline.org/english/research/sri-lanka-presidential-elections-challenges-and-opportunities-for-india [last accessed 18 November 2024].

46. The other two provinces with relatively higher concentrations of Tamil people are the Eastern Province (37%) and the Central Province (23.8%).

47. Reuters, 'What was the India China Military Clash in 2020 about?', 25 October 2024, at https://www.reuters.com/world/asia-pacific/what-was-india-china-military-clash-2020-about-2024-10-25/ [last accessed 12 December 2024].

However, after 2020, the escalation of Sino-Indian competition, combined with the shift in China's approach towards the Northern Province since 2021, has created new complications for Sri Lanka. China's recent financial and in-kind assistance to the Northern Province has not been channelled through the Sri Lankan government. It has taken the form of donations from the Chinese Embassy directly to the Northern people. Indian media have interpreted these visits as provocative, given India's traditionally strong ties to the region.[48] A visit by the Chinese ambassador to the North in November 2023, just two days after Indian Finance Minister Nirmala Sitharaman's official visit to Jaffna, can, for example, this can be seen as a manifestation of the geopolitical contest between India and China in the Northern Province.[49] Furthermore, the donations made to fishing communities in the North – affected by the unresolved dispute between India and Sri Lanka regarding Indian trawlers fishing in Sri Lankan waters – further complicate Sri Lanka's delicate balancing of India's security concerns. These developments have created a situation where Sri Lanka must constantly explain or justify its actions concerning China to avoid diplomatic issues with India. In sum, these conditions underscore the challenges faced by smaller developing countries, like Sri Lanka, in navigating the intensifying geopolitical rivalry between India and China.

3.3. Managing geopolitical pressures on policymaking

The exacerbation of Sino-Indian rivalry has led India to adopt a tougher stance in responding to China's involvement in strategic locations in Sri Lanka. This has resulted in India opposing not only the projects funded by China but also contracts awarded to Chinese firms through a competitive bidding process for projects funded by third parties such as the Asian Development Bank (ADB).

For example, a senior government official interviewed for this study recalled an instance in 2018 when India raised objections to an ADB-funded road project in the North awarded to a Chinese contractor after a competitive bidding process.[50] However, in this case, the Sri Lankan government reached an understanding with India to proceed with the project as originally planned. Similar concerns were raised by India in 2021 regarding the awarding of a contract to a Chinese contractor to build hybrid renewable energy systems in three islands off the Jaffna peninsula: Delft Island, Analativu and Nainativu. The USD 12 million project was to be funded through a loan from the ADB.These islands, separated by the Palk Strait

48. Rajat Pandit, The Times of India, 'China expands its activities to Sri Lanka's North; India worried', 1 September 2021, at https://timesofindia.indiatimes.com/india/china-expands-its-activities-to-sri-lankas-north-india-worried/articleshow/85820642.cms [last accessed 18 November 2024]; Meera Srinivasan, 'Chinese Ambassador's visit to Jaffna sparks concern, commentary in Sri Lanka', 26 December 2021, at https://www.thehindu.com/news/international/chinese-ambassadors-visit-to-jaffna-sparks-concern-commentary-in-sri-lanka/article38040843.ece [last accessed 18 November 2024].

49. Shihar Aneez, 'Chinese envoy visits Sri Lanka's province near India, promises seafood exports', 7 November 2023, at https://economynext.com/chinese-envoy-visits-sri-lankas-province-near-india-promises-seafood-exports-138519/ [last accessed 18 November 2024].

50. Key Informant Interview with a retired senior government official conducted on 24 September 2024.

India, are located close to India's Southern coast.[51] Media reports in 2024 indicated that after objecting to China's involvement in the project, India offered a USD 11 million grant to implement the hybrid power project on the three islands.[52]

Sri Lanka's efforts to limit China's presence in the North have not fully alleviated India's security concerns. Recent events indicates that India's apprehensions extends to Chinese investments in other parts of the country that are of strategic interest to India, particularly those perceived as "dual-use" facilities, such as port infrastructure. For example, India took offence at Chinese military submarines docking at the Chinese-run Colombo International Container Terminal (CICT) in 2014. India has also raised concerns over the repeated docking of so-called research vessels - dubbed by India and the West as spy ships - at Sri Lankan ports. These visits and the objections raised by India prompted Sri Lanka to take costly 'half-measures' like moratoriums on visiting 'research ships' in the absence of a clear port calls policy.[53] These examples highlight the geopolitical conundrum faced by littoral states like Sri Lanka. Ali Sabry, the foreign minister of Sri Lanka at the time, acknowledged that the arrival of such ships created "serious diplomatic tensions" and put significant pressure on the Sri Lankan government due to the disruptive effect such ships created in the region.[54]

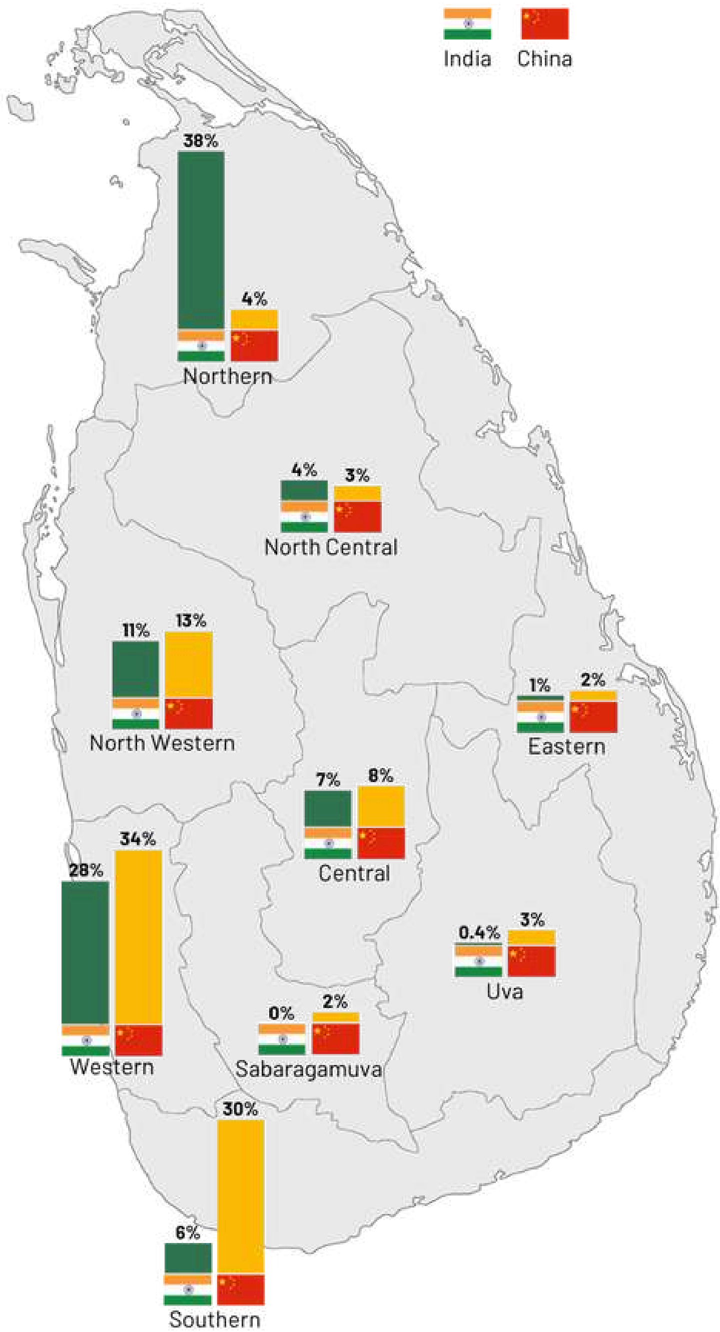
51. S. Rubatheesan, The Sunday Times, 'India fumes as China gets northern power projects', 7 February 2021, at https://www.sundaytimes.lk/210207/news/india-fumes-as-china-gets-northern-power-projects-431894.html [last accessed 18 November 2024]; Imesh Ranasinghe, Economy Next, 'Sri Lanka confirms India has objected to power projects given to China on Northern islands', 9 February 2021, at https://economynext.com/sri-lanka-confirms-india-has-objected-to-power-projects-given-to-china-on-northern-islands-78659/ [last accessed 18 November 2024].

52. Meera Srinivasan, LankaWeb, 'Displacing Chinese project, Indian firm set to build hybrid power systems in Sri Lanka's northern islands', 1 March 2024, at https://www.lankaweb.com/news/items/2024/03/01/displacing-chinese-project-indian-firm-set-to-build-hybrid-power-systems-in-sri-lankas-northern-islands/ [last accessed 18 November 2024].

53. Key Informant Interview with a retired senior government diplomat conducted on 22 October 2024.

54. WION, 'Sri Lanka's Big Blow to China: Year-long moratorium on entry of spy ships', 19 December 2023, at https://www.wionews.com/south-asia/sri-lankas-big-blow-to-china-year-long-moratorium-on-entry-of-spy-ships-671275 [last accessed 12 December 2024].

Figure 9:
Geographical distribution of finance from India and China by province for the overall period 2000-2023* (as a % of the total received during the period for each country



* The exact locations were unclear for 4% of the funding from India and 1% from China.

Source: Author's calculations using data from the External Resources Department, Ministry of Finance, BOI, Port City and SDP Act gazettes

04
Pitfalls: The Hidden Costs of Finance

This case study reveals that external geopolitical pressures combined with internally weak institutional and regulatory frameworks prone to high levels of corruption risk the costs of this tightrope balancing act of countries like Sri Lanka exceeding the benefits.

Three factors lie at the core of this problem. These factors made loans, especially from China, more attractive and, at the same time, challenging for developing countries like Sri Lanka. The first is financial, i.e., the ability to access finance at lower costs. Loans from China and India seemed cheaper than International Sovereign Bonds (ISBs), which were Sri Lanka's main alternative source of external finance at the time. Bilateral loans from China were particularly appealing after losing access to concessional financing from traditional lenders like the World Bank, ADB and Japan upon the country attaining middle-income status.

The second is political: the ability to fast-track projects within an election cycle. This was made possible by the lack of stringent external scrutiny over feasibility, environmental and social compliance and the government's ability to execute projects foregoing open tendering in favour of unsolicited proposals (USPs).

The third is private: the rent-seeking opportunities or opportunities for private gain made available to decision-makers. The absence of strict external checks by lenders and the lack of robust internal oversight within Sri Lanka's procurement framework enabled such behaviour.

This section outlines how these appealing financing features ultimately undermined Sri Lanka's ability to make the best use of the increased flow of funding from India and China, enabling rent-seeking behaviour and private interests to overshadow national priorities.

4.1. Seemingly concessional loans were non-concessional

Sri Lanka increasingly relied on non-concessional or commercial loans as traditional lenders such as the World Bank, ADB and Japan reduced concessional funding after the country was designated a lower middle-income country in 1997. On average, loans from India and China were a cheaper alternative to raising funds by issuing ISBs. The loans typically featured lower interest rates and longer maturity periods (Figures 10 and 11).

Although cheaper than ISBs, this report finds that more than half of the loans from India and China were non-concessional (i.e., they did not meet the international benchmark of a concessional loan).

A loan's grant element – the difference between the nominal loan value and the present value of the loan repayments anticipated under the loan's terms – is used as an international benchmark to assess a loan's concessionality. According to the International Monetary Fund (IMF), a loan must have a grant element of at least 35% to be considered concessional.[55] Grant element calculations of 58 Chinese loans between 2000 and 2023 reveal that 38 (or 66%) were non-concessional. Among these non-concessional loans, 30 had a grant element below 10% and four had grant elements below zero, making them less concessional than ISBs at the time. Of the 17 Indian loans, 10 (59%) were non-concessional. Two of these loans had grant elements below 10%, with one having a grant element below zero.

Figure 10:
Average interest rates for the period 2005-2019

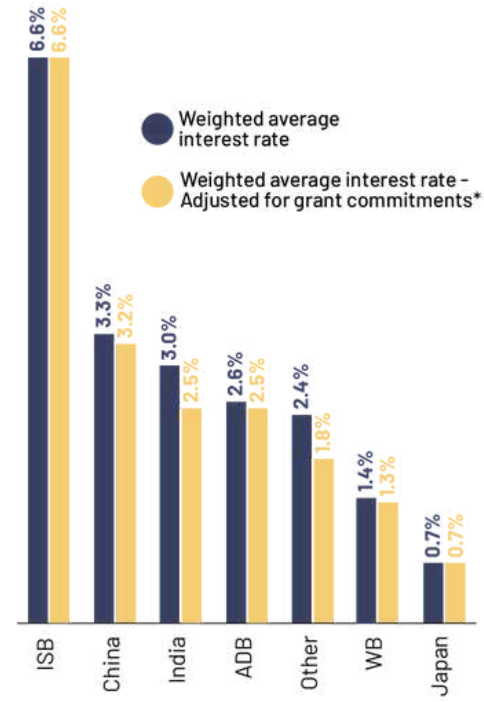
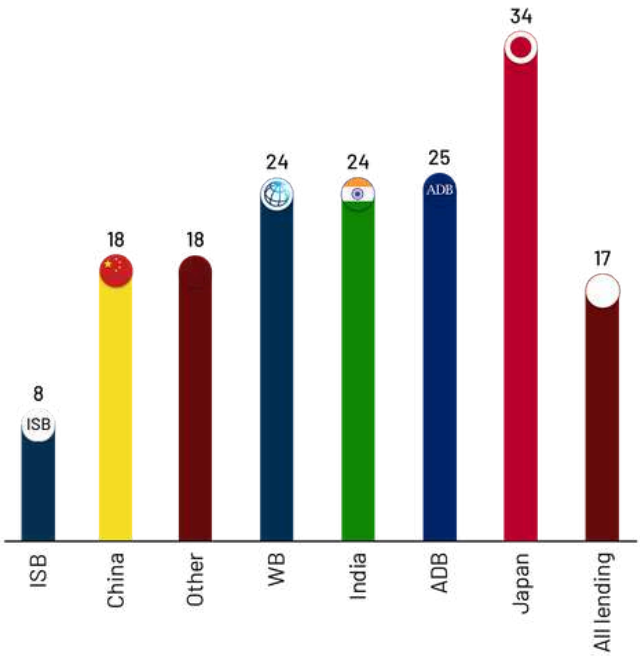


Figure 11:
Average maturity period for the period 2005-2019 (number of years)



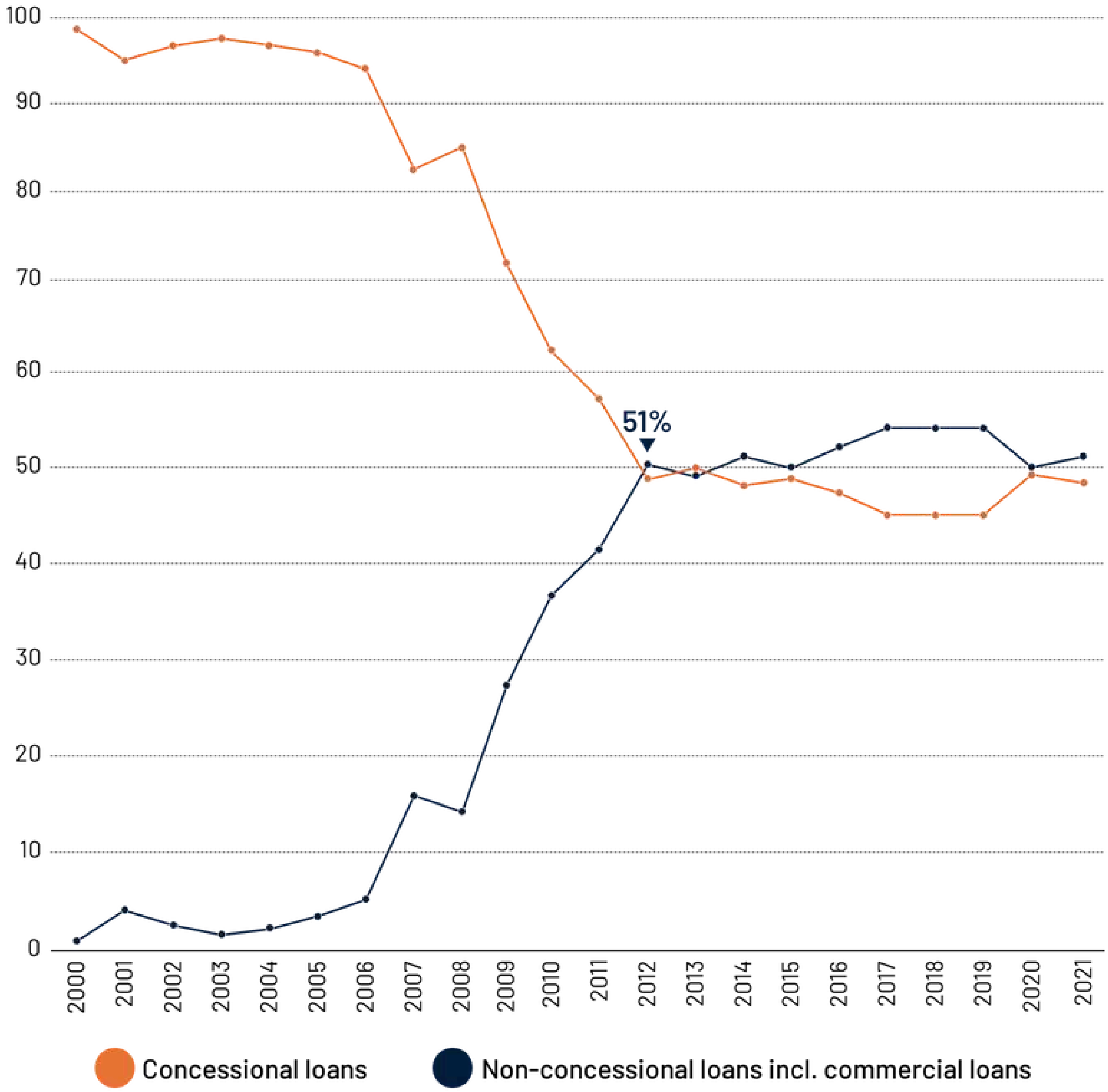
*The interest rate adjusted for grant commitments was calculated by dividing the annual interest expense by the loan plus the grant commitments. This is a more accurate measure of the actual cost of funding from each lender as it incorporates the impact of the grants provided by the lender-which don't have to be paid and don't accrue interest.

Source: Author's calculations using data from the External Resources Department, Ministry of Finance

55. Sri Lanka's average International Sovereign Bond (ISB) interest rate of 6.5% as a discount factor in the grant element calculations.

This shift in Sri Lanka's financing landscape is evident by the rapid increase in the share of non-concessional loans between 2000 and 2012, from less than 1% to 51%. The share of non-concessional financing has remained above 50% since then (Figure 12).

Figure 12:
Share of concessional & non-concessional loans (as a % of total outstanding foreign debt)



Source: Author's calculations using data from the Central Bank of Sri Lanka

4.2. Restrictive procurement conditions risked higher project costs

Beyond their non-concessional nature, the financial benefits of these loans are frequently undermined by restrictive procurement conditions. The loans from India and China are often tied, requiring contractors and materials to be sourced from the lender's country. Restrictive procurement conditions distort a loan's apparent concessionality by failing to account for the higher project costs they often impose.

An assessment by Verité Research of Sri Lanka's top 50 loans between 2005 and 2019 published in 2020 included 18 loans from China and three from India.[56] The assessment revealed that all 18 loans from China were tied, and of these, 12 funded projects originated as USPs. The contractors for the projects funded via the remaining six loans were selected before the loan agreements were signed.[57] Similarly, all three loans from India analysed were tied.[58]

Projects financed through loans and projects structured as Public-Private Partnerships (PPPs) frequently originated as USPs, i.e., proposals submitted by an external party to the public agency without an explicit request.[59] In addition to the procurement restrictions attached to the loan, the lack of competition and transparency in agreements involving USPs increased the risk of higher project costs.

To tap into China's large pool of financing, Sri Lanka even amended its procurement guidelines. The guidelines, which had been in effect since 2006, did not envisage the government entertaining USPs for public investments. USPs are typically allowed only for PPPs, not public investments. Sri Lanka's public procurement guidelines provided primacy to competitive bidding. The government amended the guidelines in 2010 to permit USPs for public investments bypassing competitive bidding.[60]

When loans have low grant elements (e.g., below 10%), and cost escalations that result from restrictive procurement conditions exceed the grant element, the apparent concessionality

56. Verité Research, 'Financing Infrastructure: The Non-Concessionality of Concessional Loans', at https://www.veriteresearch.org/publication/financing-infrastructure-the-non-concessionality-of-concessional-loans/ [last accessed 18 November 2024].

57. These are loans where the contracting companies have been selected prior to the loan agreement. However, the information available is insufficient to determine the procurement method, i.e., whether or not they originated as unsolicited proposals. However, as the contractor has been selected prior to the loan agreement, the loan could be considered to be tied.
Source: Rajat Pandit, The Times of India, 'China expands its activities to Sri Lanka's North; India worried', 1 September 2021, at https://timesofindia.indiatimes.com/india/china-expands-its-activities-to-sri-lankas-north-india-worried/articleshow/85820642.cms [last accessed 18 November 2024].

58. Verité Research, 'Financing Infrastructure: The Non-Concessionality of Concessional Loans', at https://www.veriteresearch.org/publication/financing-infrastructure-the-non-concessionality-of-concessional-loans/ [last accessed 18 November 2024].

59. Junglim Hahm and Philippe Neves, World Bank, 'Infrastructure Finance: Quick Read on Unsolicited Proposals (USPs)', November 2019, at https://ppp.worldbank.org/public-private-partnership/sites/ppp.worldbank.org/files/2022-03/InfraFinance-Quick-Read_USPs_FINAL_v3.pdf [last accessed 18 November 2024].

60. Verité Research, 'The Lure of Chinese Loans', August 2022, at https://www.veriteresearch.org/wp-content/uploads/2022/08/VR_EN_RR_Aug2022_The-Lure-of-Chinese-Loans.pdf [last accessed 18 November 2024].

of the loan is effectively negated. In such cases, Sri Lanka could have achieved better economic outcomes by funding these projects with commercial loans and implementing them through a competitive bidding process.

Cost overruns have been a significant issue for projects initiated through USPs. For example, the Gampaha, Attanagalla, Minuwangoda Water Supply project (GAMWS) loan from the China Development Bank had a grant element of only 3.5%. Research showed that the project cost exceeded the engineer's initial estimate by 33.4%, even though the estimate included a 25% profit margin.[61] Similar cost overruns were observed in other unsolicited Chinese projects. A 2014 study by Professor Amal Kumarage highlighted significant cost inflation in many highway projects funded by China in Sri Lanka, far exceeding average costs for developing countries. For example, the Southern expressway extension from Matara to Beliatta was priced 545% above standard estimates, resulting in a loss of over USD 600 million.[62]

4.3. Weak due diligence risked favouring private interests over public interest

The lax approach of Chinese lending institutions towards feasibility and social and environmental compliance made funding from these institutions politically attractive. It enabled ruling parties to expedite project completion within the five-year electoral cycle. However, it led to investments in projects that did not align with Sri Lanka's needs and priorities, undermining public interest in favour of political and private interests.

For example, the ability to bypass time-intensive due diligence processes, such as conducting detailed and thorough feasibility studies and environmental impact assessments, led to Sri Lanka investing large sums of borrowed money in vanity/white elephant projects. Most notable examples – widely quoted in international media – include the Mattala Airport, dubbed the "world's emptiest international airport", [63] and the Hambantota seaport, which had to be leased to save the operational losses incurred by the government each year.[64]

Lack of oversight and due diligence by the lenders before project approval leads to contracts being signed without carrying out the proper due diligence and even a confirmation of funding, trapping borrowers with problematic contractors or projects that cannot be cancelled due to the risk of litigation. The Governance Diagnostic Assessment (GDA) for Sri Lanka, compiled by the IMF, states that USPs that lack transparency and competition "have contributed to a large and growing portfolio of 'problem' projects and

61. *ibid.*

62. Professor Amal S. Kumarage, The Sunday Times, 'The Real Cost of Highway Development: Who Has Got the Numbers Right?', 21 December 2014, at https://www.sundaytimes.lk/141221/Cost%20of%20Expressways.pdf [last accessed 18 November 2024].

63. Shepard. W, "The Story Behind the World's Emptiest Airport", Forbes, 10 December 2021, at https://www.forbes.com/sites/wadeshepard/2016/05/28/the-story-behind-the-worlds-emptiest-international-airport-sri-lankas-mattala-rajapaksa/ [last accessed 18 December 2024].

64. Moramudali. U, "The Hambantota Port Deal: Myths and Realities", The Diplomat, 01 January 2020, at https://thediplomat.com/2020/01/the-hambantota-port-deal-myths-and-realities/ [last accessed 18 December 2024].

raised corruption concerns." [65] The IMF GDA also states that one of the common internal audit findings of the Department of Management Audit of Sri Lanka is the implementation of investment projects without feasibility studies. These findings highlight the weaknesses in the existing procurement regulatory and institutional frameworks in Sri Lanka.

Borrowing from China and India was appealing compared to traditional lenders such as Japan (JICA), ADB and the World Bank, which have internal processes within their organisations that require social and environmental compliance and project feasibility before committing funds. In contrast, projects funded by China can be completed faster as they usually rely on reports, approvals and assurances from the Sri Lankan government. Without external scrutiny, Sri Lanka's weak institutional and regulatory frameworks allowed the government – eager to accelerate project completion – to neglect rigorous feasibility and environmental assessments. Environmental impact assessments were often submitted for approval only after contracts were awarded, and, in some cases, approvals were received only after contracts were signed.[66]

The 900 MW Norochcholai Coal Power Plant – funded by China from 2005 and one of Sri Lanka's largest power suppliers – exemplifies a project plagued by operational and environmental challenges due to poor due diligence. Since its inception, the plant has experienced frequent shutdowns and faced numerous allegations of pollution, particularly concerning the toxic waste it releases, adversely impacting the surrounding communities. For instance, a June 2018 report by the Coalition Against Coal revealed several critical deficiencies, including the fact that the plant has been operating without an environmental protection licence and a waste management licence.[67]

Similar concerns regarding poor environmental compliance have been raised in relation to large-scale PPP projects involving China and India. Two notable PPPs that sparked significant public backlash were the Colombo Port City investment by China Harbour Engineering Company(CHEC)and the Mannar Wind Power Project investment by Adani Green Energy.[68]

The lack of internal and external checks also creates rent-seeking opportunities for firms and individuals involved. This, combined with weak due diligence and lack of competition in procurement, significantly undermined the ability of Sri Lanka to benefit from the increased flow of funds from China and India.

65. International Monetary Fund, 'Sri Lanka: Technical Assistance Report — Governance Diagnostic Assessment', 30 September 2023, at https://www.imf.org/en/Publications/CR/Issues/2023/09/29/Sri-Lanka-Technical-Assistance-Report-Governance-Diagnostic-Assessment-539804 [last accessed 18 November 2024].

66. Verité Research, 'The Lure of Chinese Loans', August 2022, at https://www.veriteresearch.org/wp-content/uploads/2022/08/VR_EN_RR_Aug2022_The-Lure-of-Chinese-Loans.pdf [last accessed 18 November 2024]. "https://www.veriteresearch.org/wp-content/uploads/2022/08/VR_EN_RR_Aug2022_The-Lure-of-Chinese-Loans.pdf"

67. Global Energy Monitor, 'Lakvijaya Power Plant', at https://www.gem.wiki/Lakvijaya_Power_Plant#cite_note-53 [last accessed 12 December 2024].

68. Namini Wijedasa, The Sunday Times, 'Port City Shouldn't Be Built on Half-Baked Reports: Experts', 27 December 2015, at https://www.sundaytimes.lk/151227/news/port-city-shouldnt-be-built-on-half-baked-reports-experts-176597.html [last accessed 18 November 2024]; Wildlife and Nature Protection Society (WNPS), 'Adani Wind Energy Project Challenged in Sri Lanka's Supreme Court', 19 May 2024, at https://www.wnpssl.org/news/adani_wind_energy_project_challenged_in_sri_lankas_supreme_court.html [last accessed 18 November 2024].

05
Safeguards: Overcoming Challenges & Avoiding Pitfalls

Sri Lanka's experience provides important lessons for smaller developing countries navigating the competing interests of larger powers like India and China. Smaller countries like Sri Lanka are often seen as benefitting from the competition between China and India. However, this case study reveals that external geopolitical pressures, when compounded by weak institutional and regulatory frameworks prone to corruption, often result in costs that outweigh the benefits for countries like Sri Lanka.

The competition presented an opportunity for Sri Lanka in the form of an increased inflow of finance from India and China. This case study demonstrates that without effective safeguards, these opportunities are likely to be squandered, leaving countries vulnerable to the associated challenges and risks. This section proposes measures that Sri Lanka and similarly positioned countries can adopt to safeguard national interests from external geopolitical pressures and the exploitation of these dynamics by vested interests at home and abroad.

The measures listed below are expected to effectively decouple and depoliticise financial engagements from a zero-sum balancing act, ensuring that national interests are prioritised and safeguarded amidst geopolitically motivated external pressures.

5.1. A robust, transparent and accountable public procurement framework

A robust procurement regulatory framework that is legally binding, transparent, accountable, competitive, and subject to parliamentary oversight remains critical to avoid the pitfalls discussed in Section 4. While often recognised for its role in efficiently managing scarce public resources, such a framework's value in mitigating geopolitical pressures is frequently overlooked.

The current practice of limiting investments in Sri Lanka's strategic locations to India and China under the pretext of geopolitical balancing casts doubt on the government's ability to make decisions that best serve Sri Lanka's interests. This is especially true when decisions are made ad hoc, in closed rooms, without thorough economic assessments.[69] Opaque, behind-closed-doors decision-making enables undue influence on the government and fosters rent-seeking opportunities for domestic actors involved in the decision-making process. Such non-transparent actions erode public trust and breed mistrust among all parties involved, including China, India and other major and middle powers with a stake in the Indian Ocean region. An open, competitive, transparent tendering process benefits all stakeholders by fostering mutual trust and countering vested interests.

A major contributor to Sri Lanka's challenges is its weak public procurement framework, characterised by a lack of transparency and accountability. Currently, Sri Lanka's procurement process is governed by Cabinet-approved guidelines issued in 2006 rather than legally binding acts of parliament. This framework allows the cabinet of ministers to approve projects at their discretion, bypass open tendering, and modify procurement guidelines without parliamentary oversight. In its GDA for Sri Lanka, the IMF has recognised that corruption vulnerabilities in public procurement remain high in Sri Lanka, attributing this to crony capitalism and political interference.[70] It also notes that policymakers enjoy significant discretion when determining financing methods and processes.[71]

The IMF's GDA has identified several recommendations to address corruption vulnerabilities. Implementing these without delay will help Sri Lanka manage public funds efficiently. It will also improve Sri Lanka's capacity to effectively manage strategic power rivalries in general and the competition and rivalry between India and China in particular.

These recommendations include 1) enacting a public procurement law aligned with international best practices, 2) publishing all procurement contracts exceeding LKR 1 billion, 3) establishing a robust regulatory framework for the treatment of USPs, including how they are received and evaluated and 4) online publication every six months of a list of funded projects that have originated as USPs and a list of contracts signed without a competitive contracting process.[72]

69. Shakthi De Silva, 'Tightrope Balancing in a Time of Rising Great Power Competition: An Assessment of Sri Lanka's Relations with India and China', Oasis, no. 37, 2022, pp. 47 - 68. Universidad Externado de Colombia, at https://www.redalyc.org/journal/531/53174940004/html/ [last accessed 18 November 2024].

70. International Monetary Fund, 'Sri Lanka: Technical Assistance Report — Governance Diagnostic Assessment', 30 September 2023, at https://www.imf.org/en/Publications/CR/Issues/2023/09/29/Sri-Lanka-Technical-Assistance-Report-Governance-Diagnostic-Assessment-539804 [last accessed 18 November 2024].

71. *ibid.*

72. *ibid.*

5.2. A list of priority projects aligning with the country's development needs

Including and prioritising projects, such as PPPs within a Public Investment Programme (PIP) aligned with the country's national needs and strategic priorities, will help depoliticise the decision-making process. This approach empowers countries like Sri Lanka to make independent decisions and protects them from pressure to accept geopolitically motivated projects misaligned with national priorities.

Such a project pipeline, combined with a robust procurement framework, will also help Sri Lanka diversify its funding sources and make a project's merit and feasibility the key drivers of investments, including FDI, not geopolitical balancing or hedging of rival powers.

In Sri Lanka, many PPP projects have not been implemented as part of the country's PIP. As a result, these projects are not policy-driven and are often approved outside the budget process without evaluating their fiscal implications.[73]

To address these issues, the IMF GDA recommends that all government-implemented projects be included and prioritised within the PIP.[74] This will strengthen the medium-term fiscal framework, shield Sri Lanka from giving in to external pressures within a tense geopolitical context and help ensure that public investments align with the country's priorities and needs.

5.3. Enhanced compliance with domestic transparency laws

Legal transparency mandates prevent vested interests from capturing decision-making by promoting public visibility and engagement. Sri Lanka already has a Right to Information (RTI) Act that mandates comprehensive disclosure requirements, yet compliance remains weak. Within the current tense geopolitical environment, the findings suggest that enhancing compliance with information disclosure laws will reduce room for corruption and enhance accountability. Foreign lenders can also help enhance transparency by linking lending to compliance with domestic transparency laws. Lenders also stand to benefit from encouraging information disclosure.

Projects funded by foreign lenders often require compliance with domestic environmental and social safeguards laws. International lenders and foreign governments can significantly enhance transparency by having similar compliance requirements with local laws on information disclosure, such as Sri Lanka's Right to Information Act, No. 12 of 2016. Foreign lenders' influence extends beyond providing capital; they can leverage their standing to set governance standards that mitigate corruption risks.

73. *ibid.*

74. *ibid.*

Improving transparency in foreign-funded projects benefits not only the Sri Lankan public but also lenders and contractors. Greater transparency fosters fair competition, reduces corruption risks and minimises reputational risks for lenders and contractors.[75] Additionally, transparency will help strengthen diplomatic and economic relations between the lending and borrowing countries by fostering public trust and confidence in the funded projects.

Section 9 of Sri Lanka's RTI Act and guidelines from the RTI Commission mandate proactive disclosure of project information at least three months before commencement. This disclosure must address five key areas: project details, rationale and beneficiaries, budget and financial details, approvals and clearances and procurement and contracts. However, an assessment by Verité Research on the Sri Lankan government's compliance with Section 9 of the RTI Act – covering 29 foreign-funded projects – found that the government disclosed only 40% of the required information for foreign-financed projects. Disclosure of procurement-related information, the area most prone to corruption, was even lower at just 20%.[76]

75. Newswire, 'Govt Discloses Only 40% of Required Information on Foreign-Financed Projects – Report', 2 September 2024, at https://www.newswire.lk/2024/09/02/govt-discloses-only-40-of-required-information-on-foreign-financed-projects-report/ [last accessed 18 November 2024].

76. Bulani Weerawardane and Malinda Meegoda, The Diplomat, 'Can Foreign Lenders Curb South Asia's Infrastructure Corruption?', 12 October 2024, at https://thediplomat.com/2024/10/can-foreign-lenders-curb-south-asias-infrastructure-corruption/ [last accessed 18 November 2024].

Bibliography

Ada Derana, 'Colombo Port City Project Suspended', 6 March 2015, at https://adaderana.lk/news.php?nid=30018 [last accessed 18 November 2024].

Aditya Gowdara Shivamurthy, Observer Research Foundation, 'Sri Lanka Presidential Elections: Challenges and Opportunities for India', 27 August 2024, at https://www.orfonline.org/english/research/sri-lanka-presidential-elections-challenges-and-opportunities-for-india [last accessed 18 November 2024].

Austin Strange, *Chinese Global Infrastructure* (Cambridge University Press, 2023).

Brook Larmer, The New York Times, 'What the World's Emptiest International Airport Says About China's Influence', 13 September 2017, at https://www.nytimes.com/2017/09/13/magazine/what-the-worlds-emptiest-international-airport-says-about-chinas-influence.html [last accessed 18 November 2024].

Bulani Weerawardane and Malinda Meegoda, The Diplomat, 'Can Foreign Lenders Curb South Asia's Infrastructure Corruption?', 12 October 2024, at https://thediplomat.com/2024/10/can-foreign-lenders-curb-south-asias-infrastructure-corruption/ [last accessed 18 November 2024].

Chandani Kirinde, Daily FT, 'Ferdinando appears before COPE, more questions than answers on Adani project', 24 June 2022, at https://www.ft.lk/front-page/Ferdinando-appears-before-COPE-more-questions-than-answers-on-Adani-project/44-736571 [last accessed 18 November 2024].

Christian Wagner and Siddharth Tripathi, 'India's Response to the Chinese Belt and Road Initiative', January 2018, at https://www.swp-berlin.org/publications/products/comments/2018C07_wgn_Tripathi.pdf [last accessed 18 November 2024].

Daily FT, SL, 'India and Japan sign MoC to develop ECT', 29 May 2019, at https://www.ft.lk/front-page/SL--India-and-Japan-sign-MoC-to-develop-ECT/44-679094 [last accessed 18 November 2024].

Department of National Planning, Ministry of Finance and Planning, Mahinda Chinthana, *A Vision for New Sri Lanka, Ten year development plan* (2006), at https://www.thegef.org/sites/default/files/ncsa-documents/MahindaChintanaTenYearDevelopmentPlan.pdf [last accessed 18 November 2024].

Department of National Planning, Ministry of Finance and Planning, Mahinda Chinthana, Vision for the Future (2010), at https://faolex.fao.org/docs/pdf/srl170008.pdf [last accessed 18 November 2024].

DW, 'Indian PM Modi looking to mend ties in historic visit to Sri Lanka', 13 March 2015, at https://www.dw.com/en/indian-pm-modi-looking-to-mend-ties-in-historic-visit-to-sri-lanka/a-18313419 [last accessed 18 November 2024].

Geethanjali Nataraj and Richa Sekhani, 'A New Era for India-Sri Lanka Relations', 7 March 2015, at https://eastasiaforum.org/2015/03/07/a-new-era-for-india-sri-lanka-relations/ [last accessed 12 December 2024].

Global Energy Monitor, 'Lakvijaya Power Plant', at https://www.gem.wiki/Lakvijaya_Power_Plant#cite_note-53 [last accessed 12 December 2024].

Hongying Wang, 'A Deeper Look at China's "Going Out" Policy', March 2016, at https://www.cigionline.org/static/documents/hongying_wang_mar2016_web.pdf [last accessed 18 November 2024].

Imesh Ranasinghe, Economy Next, 'Sri Lanka confirms India has objected to power projects given to China on Northern islands', 9 February 2021, at https://economynext.com/sri-lanka-confirms-india-has-objected-to-power-projects-given-to-china-on-northern-islands-78659/ [last accessed 18 November 2024].

Indo-Pacific Defense Forum, "Malacca Dilemma' drives PRC policies, aggression', 28 November 2023, at https://ipdefenseforum.com/2023/11/malacca-dilemma-drives-prc-policies-aggression/ [last accessed 18 November 2024].

International Monetary Fund, 'Sri Lanka: Technical Assistance Report — Governance Diagnostic Assessment', 30 September 2023, at https://www.imf.org/en/Publications/CR/Issues/2023/09/29/Sri-Lanka-Technical-Assistance-Report-Governance-Diagnostic-Assessment-539804 [last accessed 18 November 2024].

Ishara Gamage, Ceylon Today, 'India's Adani Group Plans Logistics Centre in Colombo Port', 29 February 2024, at https://ceylontoday.lk/2024/02/29/indias-adani-group-plans-logistics-centre-in-colombo-port/ [last accessed 18 November 2024].

Junglim Hahm and Philippe Neves, World Bank, 'Infrastructure Finance: Quick Read on Unsolicited Proposals (USPs)', November 2019, at https://ppp.worldbank.org/public-private-partnership/sites/ppp.worldbank.org/files/2022-03/InfraFinance-Quick-Read_USPs_FINAL_v3.pdf [last accessed 18 November 2024].

Kelum Bandara, Daily Mirror, 'India seeks to operate KKS Port for 30 years: Official', 6 August 2024, at https://www.dailymirror.lk/breaking-news/India-seeks-to-operate-KKS-Port-for-30-years-Official/108-288850 [last accessed 18 November 2024].

Meera Srinivasan, 'Chinese Ambassador's visit to Jaffna sparks concern, commentary in Sri Lanka', 26 December 2021, at https://www.thehindu.com/news/international/chinese-ambassadors-visit-to-jaffna-sparks-concern-commentary-in-sri-lanka/article38040843.ece [last accessed 18 November 2024].

Meera Srinivasan, LankaWeb, 'Displacing Chinese project, Indian firm set to build hybrid power systems in Sri Lanka's northern islands', 1 March 2024, at https://www.lankaweb.com/news/items/2024/03/01/displacing-chinese-project-indian-firm-set-to-build-hybrid-power-systems-in-sri-lankas-northern-islands/ [last accessed 18 November 2024].

Ministry of Foreign Affairs, Sri Lanka, 'President Maithripala Sirisena Undertakes Successful State Visit to the People's Republic of China', 27 March 2015, at https://mfa.gov.lk/president-maithripala-sirisena-undertakes-successful-state-visit-to-the-peoples-republic-of-china/ [last accessed 18 November 2024].

Ministry of Foreign Affairs, Sri Lanka, "Sri Lanka and China agree to deepen their strategic cooperative partnership", 16 September 2014 at https://mfa.gov.lk/sri-lanka-and-china-agree-to-deepen-their-strategic-cooperative-partnership/ [last accessed 15 December 2024].

Ministry of Finance and Mass Media, Sri Lanka, 'Note to the Cabinet: Gampaha Attanagalla, Minuwangoda Integrated Water Supply Project', 21 May 2018.

Moramudali. U, "The Hambantota Port Deal: Myths and Realities", The Diplomat, 01 January 2020, at https://thediplomat.com/2020/01/the-hambantota-port-deal-myths-and-realities/ [last accessed 18 December 2024].

Namini Wijedasa, The Sunday Times, 'Port City Shouldn't Be Built on Half-Baked Reports: Experts', 27 December 2015, at https://www.sundaytimes.lk/151227/news/port-city-shouldnt-be-built-on-half-baked-reports-experts-176597.html [last accessed 18 November 2024].

Newswire, 'Govt Discloses Only 40% of Required Information on Foreign-Financed Projects – Report', 2 September 2024, at https://www.newswire.lk/2024/09/02/govt-discloses-only-40-of-required-information-on-foreign-financed-projects-report/ [last accessed 18 November 2024].

Professor Amal S. Kumarage, The Sunday Times, 'The Real Cost of Highway Development: Who Has Got the Numbers Right?', 21 December 2014, at https://www.sundaytimes.lk/141221/Cost%20of%20Expressways.pdf [last accessed 18 November 2024].

Rajat Pandit, The Times of India, 'China expands its activities to Sri Lanka's North; India worried', 1 September 2021, at https://timesofindia.indiatimes.com/india/china-expands-its-activities-to-sri-lankas-north-india-worried/articleshow/85820642.cms [last accessed 18 November 2024].

Rup Narayan Das, 'Sri Lanka's Balancing Act Between China and India', China Brief Volume: 21 Issue: 23, 3 December 2021, at https://jamestown.org/program/sri-lankas-balancing-act-between-china-and-india/ [last accessed 18 November 2024].

Reuters, 'What was the India China Military Clash in 2020 about?', 25 October 2024, at https://www.reuters.com/world/asia-pacific/what-was-india-china-military-clash-2020-about-2024-10-25/ [last accessed 12 December 2024].

S. Rubatheesan, The Sunday Times, 'India fumes as China gets northern power projects', 7 February 2021, at https://www.sundaytimes.lk/210207/news/india-fumes-as-china-gets-northern-power-projects-431894.html [last accessed 18 November 2024].

Sahan Tennekoon, The Morning, 'Mattala Airport: Indo-Russo venture 'unlikely': Min.', 12 November 2024, at https://www.themorning.lk/articles/vy1fZuk7ga7XcTxxB3uo [last accessed 18 November 2024].

Shepard. W, "The Story Behind the World's Emptiest Airport", *Forbes*, 10 December 2021, at https://www.forbes.com/sites/wadeshepard/2016/05/28/the-story-behind-the-worlds-emptiest-international-airport-sri-lankas-mattala-rajapaksa/ [last accessed 18 December 2024].

Shihar Aneez, 'Chinese envoy visits Sri Lanka's province near India, promises seafood exports', 7 November 2023, at https://economynext.com/chinese-envoy-visits-sri-lankas-province-near-india-promises-seafood-exports-138519/ [last accessed 18 November 2024].

Siddharth Varadarajan, 'India-Lanka-China Relations: The Growing Strategic Competition and the LTTE Factor', 29 December 2016, at https://thewire.in/diplomacy/india-lanka-china-menon-ltte [last accessed 18 November 2024].

Spencer Feingold, World Economic Forum, 'China's Belt and Road Initiative turns 10. Here's What to Know', 20 November 2023, at https://www.weforum.org/stories/2023/11/china-belt-road-initiative-trade-bri-silk-road/ [last accessed 18 November 2024].

StratNewsGlobal, 'We have an India First Policy on Strategic Security: Sri Lankan Foreign Secretary', 24 August 2020, at https://stratnewsglobal.com/sri-lanka/we-have-an-india-first-policy-on-strategic-security-sri-lankan-foreign-secretary/ [last accessed 12 December 2024].

Suhasini Haidar, 'Sri Lankan Foreign Minister Ali Sabry is Confident that India's Adani Group's Current Financial Crisis will not Affect its Envisaged Projects in Sri Lanka - Interview with Suhasini Haidar of "The Hindu"', 8 March 2023, at https://dbsjeyaraj.com/dbsj/?p=81520 [last accessed 18 November 2024].

Verité Research, 'Financing Infrastructure: The Non-Concessionality of Concessional Loans', at https://www.veriteresearch.org/publication/financing-infrastructure-the-non-concessionality-of-concessional-loans/ [last accessed 18 November 2024].

Verité Research, 'National Media Portrayal of China in Sri Lanka – A Case Study of Colombo Port City and Hambantota Port' (December 2019).

Verité Research, 'The Lure of Chinese Loans', August 2022, at https://www.veriteresearch.org/wp-content/uploads/2022/08/VR_EN_RR_Aug2022_The-Lure-of-Chinese-Loans.pdf [last accessed 18 November 2024].

The Times of India, "I don't think we should be scared of China, rather .....": EAM Jaishankar", 30 January 2024, at https://timesofindia.indiatimes.com/india/i-dont-think-we-should-be-scared-of-china-rather-eam-jaishankar/articleshow/107260144.cms [last accessed 15 December 2024].

Wildlife and Nature Protection Society (WNPS), 'Adani Wind Energy Project Challenged in Sri Lanka's Supreme Court', 19 May 2024, at https://www.wnpssl.org/news/adani_wind_energy_project_challenged_in_sri_lankas_supreme_court.html [last accessed 18 November 2024].

WION, 'Sri Lanka's Big Blow to China: Year-long moratorium on entry of spy ships', 19 December 2023, at https://www.wionews.com/south-asia/sri-lankas-big-blow-to-china-year-long-moratorium-on-entry-of-spy-ships-671275 [last accessed 12 December 2024].

Zulfick Farzan, News First, 'Cabinet Nod For Russia, Indian Management For Mattala International Airport', 26 April 2024, at https://www.newsfirst.lk/2024/04/26/cabinet-nod-for-russia-indian-management-for-mattala-international-airport [last accessed 18 November 2024].

Annexures

Annexure 1: Composition of bilateral finance – grants, loans & FDI

Bilateral loan commitments by source of finance (2000 - 2023)

Lender	USD Mn	% of total
China	12,422	45%
India	6,244	23%
Japan	5,828	21%
Germany	517	2%
France	505	2%
Korea	464	2%
Saudi Arabia	360	1%
Russia	300	1%
Kuwait	197	1%
Spain	119	0.4%
Sweden	119	0.4%
United States	112	0.4%
Iran	93	0.3%
Pakistan	60	0.2%
Denmark	51	0.2%

Lender	USD Mn	% of total
Hungary	45	0.2%
Netherlands	32	0.1%
Australia	14	0.1%
Italy	9	0.03%
Malaysia	6	0.02%
Total bilateral	27,496	100%

Source: Author's calculations using data published by the External Resources Department, Ministry of Finance and the Central Bank of Sri Lanka

Bilateral grant commitments by source of finance (2000 - 2023)

Donor	USD Mn	% of total
Japan	613	24%
China	535	21%
India	337	13%
USA	324	12%
Germany	309	12%
Netherlands	160	6%
Republic of Korea	119	5%
Sweden	89	3%
Australia	34	1%
Norway	21	1%
Switzerland	19	1%
United Kingdom	12	0.47%
Finland	9	0.35%
Denmark	8	0.30%
France	6	0.24%
Venezuela	6	0.24%
Canada	2	0.09%
Pakistan	1	0.05%

Donor	USD Mn	% of total
Kuwait	1	0.03%
Qatar	1	0.02%
Total bilateral	2,607	100%

Source: Author’s calculations using data published by the External Resources Department, Ministry of Finance and the Central Bank of Sri Lanka

Leading sources of foreign direct investments into Sri Lanka (as a % of the total stock of FDI received as of the end of 2023)

FDI sources	% of total
India	15%
China	15%
Singapore	13%
Netherlands	8%
Hong Kong	8%
United Kingdom	5%
Malaysia	5%
Mauritius	4%
Japan	3%
UAE	3%
British V. I	3%
Italy	3%
Canada	2%
United States	2%
Switzerland	2%
Australia	2%
Sweden	1%
Other	6%

Source: Author’s calculations using data published by the Central Bank of Sri Lanka

Annexure 2: Sectoral distribution of infrastructure funding

Sectoral distribution of infrastructure funding from China

Sector	2000 - 2004	2005 - 2009	2010 - 2014	2015 - 2019	Overall (in USD Mn)
Military/police/law and order	0.0%	0.0%	0.0%	0.0%	0.03
Disaster mitigation and climate change	0.0%	0.9%	0.0%	0.0%	18
Domestic transport - Highways	0.0%	12.4%	25.9%	48.6%	3,264
Domestic transport - Railways	0.0%	0.0%	4.2%	0.0%	283
Domestic transport - Roads	0.0%	0.5%	21.9%	3.3%	1,567
Housing development	0.0%	0.0%	0.0%	2.2%	58
International transport - Airport	0.0%	0.0%	2.7%	0.0%	181
International transport - Seaport	0.0%	15.3%	21.3%	0.0%	1,741
Power and energy	93.2%	70.5%	5.2%	3.3%	1,941
Special economic zone	0.0%	0.0%	16.4%	0.0%	1,104
Sports, culture and community development	6.8%	0.4%	0.0%	0.0%	15
Telecommunications	0.0%	0.0%	1.3%	0.0%	89
Water and sanitation	0.0%	0.0%	1.2%	42.7%	1,194

Source: Author's calculations using data from the External Resources Department, Ministry of Finance, BOI, Port City and SDP Act gazettes

Sectoral distribution of infrastructure funding from India

Sector	2000 - 2004	2005 - 2009	2010 - 2014	2015 - 2019	Overall (in USD Mn)
Domestic transport - Railways	91.5%	70.8%	50.8%	0.0%	1,277
Education and technical training	0.6%	0.6%	0.6%	0.0%	11
Health	7.9%	0.0%	0.3%	0.0%	10
Housing development	0.0%	22.0%	0.0%	0.0%	267
International transport - Seaport	0.0%	1.6%	7.2%	84.7%	618
Power and energy	0.0%	0.0%	0.0%	15.3%	100
Water and sanitation	0.0%	5.0%	41.0%	0.0%	317

Source: Author's calculations using data from the External Resources Department, Ministry of Finance, BOI, Port City and SDP Act gazettes

Annexure 3: History and origin of key projects* funded by China

*The projects listed represent up to 55% of the total infrastructure funding by India and China during 2000 - 2023.

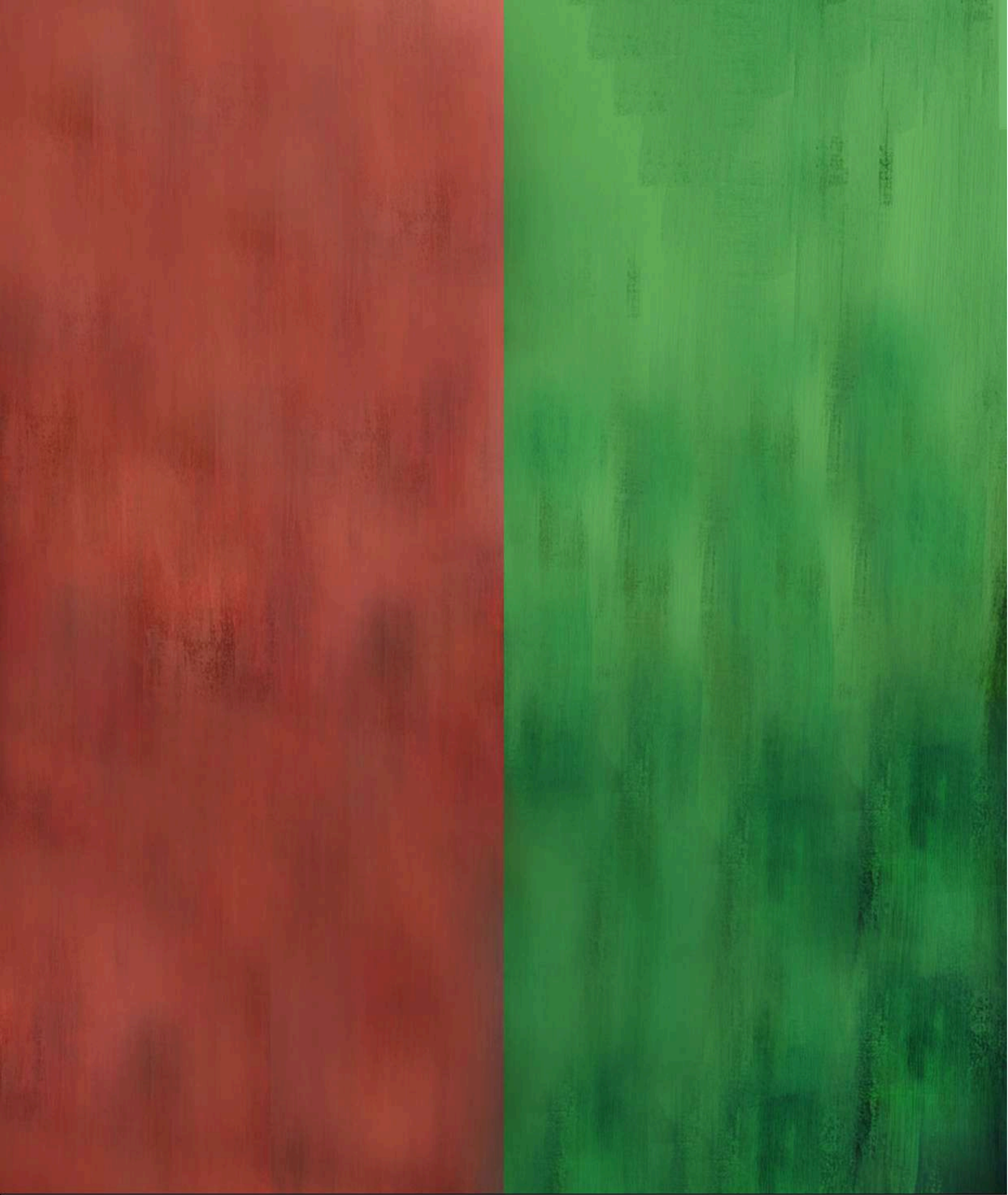
Project name	Year contracted	USD Mn	Year first mentioned and source
Extension to Southern Expressway	2014 - 2016: Loan from China	1,518	2007: Mentioned in the National Road Master Plan (2007 - 2017) - Economic Feasibility Study for the Proposed Extension to the Southern Expressway
Puttalam Coal Power Plant	2005 - 2009: Loan from China	1,344	1988: Referred to in "West Coast Candidate Development Sites for Coal-Fired Thermal Power Plant" conducted by the U.S. firm Black & Veatch 1993: Pre-feasibility study 1996: Site screened by Electrowatt Engineering Services Ltd 1998: Mentioned in an engineering design survey
Hambantota Port	2007 - 2013: Loan from China 2017: Leased by China	Loan:1,158 Lease: 1,120	1997: First mentioned in the Report on Proposed Hambantota Harbour Pre-Feasibility Study, Southern Development Authority of Sri Lanka 2003: Feasibility study 2006: Hambantota Port Pre-Feasibility Study, Ramboll et al
Central Expressway Project - Section 1 from Kadawatha to Meerigama	2019: Loan from China	989	2001: First mentioned in the Colombo-Kandy Alternative Highway Feasibility Study – December 2001: Resource Development Consultants Pvt. Ltd 2016: Economic feasibility analysis for Central expressway project

Project name	Year contracted	USD Mn	Year first mentioned and source
Matara-Beliatta section of Matara-Kataragama Railway Extension Project	2013: Loan from China	283	1993: Matara-Kataragama railway extension project – environmental assessment 2005: Mahinda Chinthana mentions extending the rail line to Hambantota 2006: Mahinda Chinthana mentions extending the rail line to Hambantota 2009: Environmental Impact Assessment (EIA) Report (not available online; image of the document is available) 2010: Mahinda Chinthana mentions extending the rail line to Beliatta
Colombo International Container Terminals Ltd (CICT)	2011: Investment from China	583	1995: Public invitations were called by the Ports Authority from private investors 2001: The ADB conducted a feasibility study on grant assistance and provided a technical assistance loan to the Ports Ministry to conduct detailed engineering designs and all other documents required to implement the project 2005: All prerequisites were completed 2006: Mahinda Chinthana mentions parallel work on Colombo South Harbour
Colombo West International Terminal (Pvt.) Ltd	2022: Investment by India	553	2005: Environmental Impact Assessment Report 2008: The Colombo Port expansion project commenced 2021: The cabinet of ministers approved the development of the project as a public-private partnership project on a build-operate-transfer basis

Project name	Year contracted	USD Mn	Year first mentioned and source
Construction of Outer Circular Highway Project Phase III from Kerawalapitiya to Kadawatha	2014: Loan from China	379	1991: RDA proposal to conduct the pre-feasibility study 1993: Pre-feasibility study conducted by Consulting Engineer & Architects Associated 1998: Japan International Cooperation Agency Feasibility Study 2000: The Study on Outer Circular Highway to the City of Colombo Final Report 2001: The Study on Outer Circular Highway to the City of Colombo Final Report 2007: Central Environmental Authority approval letter for outer circular highway 2008: The Detailed Design Study on the Outer Circular Highway to the City of Colombo 2010: Central Environmental Authority Annual Report 2010 2012: Feasibility study to connect Padeniya to an appropriate location on the expressway network
Colombo-Katunayake Expressway (CKE)	2009: Loan from China	248	1983: JICA Feasibility Study 1996: Colombo Katunayake Expressway Environmental Impact Assessment Report 1997: Environmental Impact Assessment (EIA) of Colombo-Katunayake Expressway Project 2000: The Study on Outer Circular Highway to the City of Colombo Final Report: 2000/2001
Moragahakanda Development Project	2012: Loan from China	214	1998: Environmental Impact Assessment Report 2001: Environmental approval given by the project approving agency (PAA – Ministry of Agriculture Development and Agrarian Services) and the Central Environmental Authority (CEA) 2008: Partnership for Sustainable Development Report 2008

Project name	Year contracted	USD Mn	Year first mentioned and source
Housing Project (41,675 houses)	2010: Grant from India	196	2005: Mahinda Chinthana expressed plans to build 80,000 houses 2010: 150,000 homes for those who were internally displaced (Mahinda Chinthana 2010)
Mattala Hambantota International Airport Project	2010: Loan from China	181	2006: Mahinda Chinthana Horizon Development Plan 2006

Source: Various sources including project feasibility studies, Environmental Impact Assessment Reports, National Road Master Plans, Mahinda Chinthana and other development plans



ISBN 978-624-5514-34-2

VERITÉ RESEARCH
Strategic Analysis for Asia

A | No. 5A, Police Park Place, Colombo 5
T | +94 11-2055544
E | reception@veriteresearch.org
W| www.veriteresearch.org