

## CHAPTER I

### INTRODUCTION

This chapter aims to provide an intro and a general overview that Sri Lanka has indeed fallen into the debt trap from the BRI project, as concluded and evidenced by several indicators which will be further detailed in the chapter 4 and 5 which are the analysis and discussion part of this thesis. This chapter also provides a general overview of the historical background of Sri Lanka as a country and the origin of the BRI project, how it is established cooperation and how it managed to reach Sri Lanka. The other part of this chapter is the research questions, research objectives, research significance, and thesis outline.

#### 1.1. Background

In recent times, China's ambitious global strategy, notably showcased through the Belt and Road Initiative (BRI), has attracted a lot of interest as the country works to increase its influence and fortify its economic bond globally. The Belt and Road Initiative (BRI) is China's major 21st-century strategy encompassing the development of large industrial corridors and cross-continental connectivity networks, linking China with Europe through Southeast Asia, South Asia, and Central Asia (Ali, 2020). The BRI has brought about significant changes in various fields such as economics and politics, consequently bolstering China's emergence as a major power and exerting significant impacts, especially in Asian countries. While BRI's popularity was growing in the participating countries, it also brought

with it a number of criticisms from the highly developed industrial economic systems.

One major criticism is its lack of transparency, making it difficult to determine how many Chinese companies are involved in each project, the contractual terms, the manner in which contractors are selected, and the potential environmental and social risks. When it comes to the assertion that most major developing countries have weak democratic and people's freedom, the BRI is also criticized as an attempt to impose a Chinese style of governance. These countries include Zimbabwe in Africa, Kamboja, Laos, and Sri Lanka in Asia, and Venezuela in Latin America (Haderiansyah et al., 2020).

However, as China assumes a more prominent role in international relations, concerns have surfaced regarding potential drawbacks of its economic strategies. One of these concerns is the potential for a "debt-trap", where countries receiving BRI investments become burdened with unsustainable debt levels (Chellaney, 2017). Over time, there are also various opinions and perspectives have been expressed by the public, particularly economists, scholars, and Western nations, prompting literature to analyze the scheme of BRI or how it works, in response to BRI projects that have been implemented in various regions in Asia. Hence, the controversial concept commonly used to interpret the BRI, known as the "debt-trap" concept, has emerged (Sachini, 2022). Debt can be defined as the situation of owing something to someone else or state generally with interest, or as anything owed to someone, especially money (Cambridge Dictionary, 2023).

According to the Oxford Dictionary, a debt trap occurs when repayment of the principal amount of a debt is hindered by high interest payments, making it difficult or impossible to pay off the debt (Oxford Dictionary, n.d.). This term means that a debt trap happens when people or institution stuck in a situation where its really hard or even impossible to pay back what they owe, because they have to pay so much in interest that they cannot make progress on paying off the actual debt they owe. A highly controversial term first emerged from Brahma Chellaney, an Indian academic. Chellaney (2017) in his article, "China's Debt-Trap Diplomacy" uses the term of "Debt-Trap Diplomacy" to criticize BRI's performance in Sri Lanka as a "debt-trap".

Chellaney (2017) interprets the BRI project into this term to explain how the BRI project scheme leads to the asset or infrastructure seizure in Sri Lanka, due to its inability to repay loans to China, so that the Chinese government is accused of providing loans to small and developing countries, as a way to expand China's political influence and provide access to China in the form of facilities, infrastructure or natural resources that will benefit China's more. The term of "Debt-Trap Diplomacy" also emerged after two master's students from Harvard University titled their paper as China's 'debt book diplomacy' which was cited directly by *The Guardian and The New York Times* and other media. Since then, the term of "debt-trap" has become increasingly popular and widely used (Brautigam, 2020). Despite criticisms stating that BRI projects have debt-trap schemes, there are also opinions suggesting that BRI projects actually help to

improve the economy of collaborating countries, especially small and developing countries. So, what is actually happening? is the BRI debt trap just a myth?

There is often a question as to why China is so keen to cooperate or become a major financier in Pacific or Asian countries? The Pacific region has attracted the interest of major powers like China to provide more loans in the area. China has emerged as a significant financial power that also catches the attention of the Pacific, including the BRI projects. In reality, BRI projects in the Pacific have raised concerns about debt sustainability and accusations that China is deliberately setting up debt traps in the region. It is very sensitive when it comes to debt. Debt can play a very important role for a country in overcoming certain problems such as financing development and infrastructure, if it is well-targeted and with due regard to the sustainability of the debt itself. Otherwise, if the debt is not well-targeted and does not pay attention to its sustainability, then it will only lead to what is referred to as a "debt trap situation". This is also the case in developing countries such as Pacific countries. Pacific countries themselves are among the most vulnerable and risky countries, given their small size and have a fairly high level of structural vulnerability, as well as being the most indebted countries to China (Rajah, et al., 2020).

There are conflicting signals from various power corridors, which makes sense given the scale and scope of the effort, which aims to finance infrastructure and communication projects throughout Asia, Africa, and Europe. Some countries consider China's growing influence as a potential source of additional funding for the development and modernization of infrastructure, as well as for quickening the

industrialization process. Others see the BRI as China's geopolitical and security gambit to establish and strengthen its influence across a range of regions. This may be particularly evident in the case of South Asia, where China's involvement is viewed less as an economic force and more as a military and geopolitical one to assist its immediate neighbors in resolving their major development issues, such as oil scarcity (Ali, 2020). Only a small portion of China's official development finance is provided in the form of grants; the bulk of its funding is provided globally as loans (Brautigam, 2019). China's state-owned policy banks, the China Development Bank and the Export-Import Bank of China (EXIM Bank), have been the main providers of funding for development in the country (Wignaraja, et al., 2020). Under the BRI umbrella, China's state-owned commercial banks are increasingly emerging as significant foreign lenders. This, along with the significant amount of Chinese lending that is anticipated under the BRI, has raised worries about the initiative's potential to cause issues with debt sustainability in developing nations worldwide.

Additionally, it has given rise to allegations of "debt trap" diplomacy, which maintain that China deliberately works to inflate nations' debt levels in order to get geopolitical concessions. If adequate consideration is paid to guaranteeing debt sustainability, debt can play a significant role in financing development. However, there are significant concerns regarding possible debt sustainability issues in many developing countries due to the scale, nature, and lack of transparency of China's lending activities in the BRI. Sri Lanka is one of the countries stuck in the BRI debt trap. The situation involving Sri Lanka's Hambantota Port, where a Chinese state-

owned enterprise secured a majority ownership stake in this strategically significant port following the nation's debt-related issues, has many geostrategic analysts concerned (Rajah, et al., 2020).

What indicators suggest that Sri Lanka has fallen into the debt trap of the BRI? Why did Sri Lanka choose to borrow from China, despite being geographically close to India? To answer these questions, it is important to briefly review Sri Lanka's history and profile as a country and its relationship with India. Sri Lanka has a rich history of engagement in international affairs dating back over 2000 years. From its introduction to international diplomacy through the introduction of Buddhism by Emperor Asoka to its pivotal role in maritime trade routes, Sri Lanka plays a significant role in shaping regional and global dynamics (Mendis 1998). Sri Lanka, known as Ceylon, boasts a history that spans over 2000 years during British colonialism. Its story begins with the arrival of Sinhalese settlers around the 6th century B.C., likely originating from northern India (labip umy, 2022).

If we look at its historical background, Sri Lanka was part of India before gaining its independence from the British Colonialism. However, Sri Lanka desired to reduce Indian influence. Sri Lanka is an island nation in the South Asian continent located to the Southeast of India, with a population of over 21 million, it is predominantly composed of the native Sinhalese at 74.9%, followed by Sri Lankan Tamils at 11.2%, and 10% being Moors (Christiawan, Prajna & Haryo, 2022). The Sinhalese predominantly adhere to Buddhism, Tamils to Hinduism, and Moors to Islam. Certainly, these ethnic groups have significant differences, but

religion isn't the primary factor causing tension between Sinhalese and Tamils. Most Historians believe that Tamils initially arrived from India to Sri Lanka for trade. Therefore, it was the acquisition of power that actually sparked tensions between Sinhalese and Tamils (Ross and Savada, 1988).

During the British colonialism, there was a favoritism towards the Tamil ethnic group, which was perceived to still exist in the British colony areas. Sinhalese people felt isolated and oppressed as a result of this favoritism, as Tamils received preferential treatment from the British, including access to education and employment. Consequently, after Sri Lanka gained independence from British in 1948, the dominance of Tamil ethnic group changed drastically, and power shifted to the Sinhalese (Povlock, 2011).

They even made an educational standardization for the Tamils to get the higher score than the Sinhala students just to be accepted at the University of Sri Lanka. In response to this discriminatory act, the Tamils created a Tamil Eelam idea, which is an idea that wants to separate itself from Sri Lanka, and stand alone. The well-known movement of Tamil Eelam is the Liberation Tigers of Tamil Eelam (LTTE). The conflict between the Sinhalese and the Tamil became escalated and it is developing into a long-running civil war, which took place in 1983-2009. Therefore, India initially supported the Tamil minority in Sri Lanka during the Sri Lanka Civil War because of its political and cultural ties with the Tamil population in its own state, Tamil Nadu (Anandakugan, 2020).

This support included backing Tamil groups such as the Liberation Tigers of Tamil Eelam (LTTE) at certain points. However, as the conflict progressed, India's role shifted. In 1987, India deployed the Indian Peace Keeping Force (IPKF) to Sri Lanka to enforce a peace agreement and suppress Tamil rebels. This mission was controversial and faced resistance from both the LTTE and some segments of Sri Lankan society, leading to strained relations between India and Sri Lanka. After the war, there were concerns in Sri Lanka about India's influence in its internal affairs. Some in Sri Lanka viewed India's involvement with suspicion and sought to reduce dependence on India by engaging with other international partners, such as China's Belt and Road Initiative (BRI). So, how did Sri Lanka establish cooperation with China? China has been the largest creditor to Sri Lanka since the tenure of Mahinda Rajapaksa's administration around 2005-2015 (Shivamurthy, 2022).

The Rajapaksa family is known to be highly influential and wield dominant political power in Sri Lanka. Rajapaksa, recognized as a populist leader, successfully ended the war in 2009, making him very popular among the people of Sri Lanka, especially the Sinhalese (Christiawan and Haryo, 2022). China saw this as a significant opportunity, so even when Rajapaksa was criticized by the West and India for human rights violations, China stood by Rajapaksa (Chellaney, 2017). In fact, China was one of the actors supplying weapons to Sri Lanka during the civil war (Chaudhury, 2019). China became a significant funder of development aid and foreign direct investment (FDI) in Sri Lanka. As Sri Lanka pursued economic recovery and proposed various large-scale infrastructure projects, China eagerly



invested in them. This eagerness is driven by China's expanding economic influence and its ambition to become the next major power in Asia. Conversely, Sri Lanka finds it more convenient to seek help from China due to the rapid loan disbursements and China's minimal concern with Sri Lanka's internal matters. Additionally, China often offers technical, financial, and economic support for these projects.

Globally, the majority of China's official development funding is channeled in the form of loans rather than grants, with only a small portion of these loans being concessional (Brautigam, 2019). From this case, it can also be seen that there were mistakes in the Rajapaksa government's reckless acceptance of loans from China. Rajapaksa, who only wanted to exploit this for his political and economic interests, would only make Sri Lanka pay dearly for all of this. In fact, China is the largest creditor to Sri Lanka with total unpaid debt, amounting to twice the existing debt stock. In 2022, Sri Lanka's debt stock to China is 10%, while its outstanding debt to China is 20% (ERD, 2022). This means Sri Lanka has to pay high interest rates to China. According to the Department of External Resources, the total outstanding external debt of the central Government was US\$ 34.8 billion in 2022 and China accounts for 45% of bilateral creditors.

Additionally, it is known that during the Mahinda Rajapaksa administration, there was much chaos in fiscal policy management and other policies underlying the worsening economy of Sri Lanka, including decisions to accept the funding from the Belt and Road Initiative (BRI) with its ineffective and unproductive mega infrastructure projects (Christiawan, Prajna & Haryo, 2022). Mahinda Rajapaksa

(2005-2015) agreed to cooperate with the BRI through infrastructure projects including the Norocholai coal power plant, Hambantota port, Mattala International Airport, Colombo International Container Terminal, and the Lotus Tower (Wignaraja, et al., 2020).

Sri Lanka has become a crucial Maritime Silk Road due to its connection between Asia and Europe, thus playing a significant role in China's Belt and Road Initiative (BRI) (Weerakoon and Wijayasiri, 2019). Sri Lanka obtained funds from China amounting to USD 9.2 billion for development in 2017, with the majority of these funds (USD 7.2 billion) sourced from EXIM and the China Development Bank (CDB) (ERD, 2018). At least the descriptions above have indicated that BRI projects have led Sri Lanka into a debt trap situation, further reinforced by several reasons that the BRI has indeed created a debt trap in Sri Lanka. First, it has increased the debt burden and led to asset seizures in Sri Lanka. In fact, during the Rajapaksa administration, Sri Lanka continued to experience budget deficits, and foreign debt continued to accumulate (Christiawan, Prajna & Haryo, 2022).

At the end of 2016, just as the Mahinda Rajapaksa government ended, Sri Lanka had foreign debt amounting to US\$46.4 billion, which was 57% of the total GDP at that time (Central Bank of Sri Lanka, 2016). Interestingly, only 10% of it, was debt owed by Sri Lanka to China. So, where did the mistake lie? The government viewed the Hambantota port project as one favored by Rajapaksa, hence they sought to privatize the majority stake in the Hambantota port to increase foreign exchange for future debt payments. CM Port, a Chinese company, was

chosen as the majority shareholder buyer and has developed the port with significant investment. The sale of Hambantota was initially aimed at addressing larger debt issues, but it ended up being a disaster for Sri Lanka due to the heavier burden of debt under the controversial 99-year lease agreement with China Merchants Port Holdings Company in 2017 (Brautigam, 2019).

Second, the Chinese government was actually aware of Sri Lanka's capacity as a developing country. So why did the Chinese government provide loans so easily to Sri Lanka, which clearly had a record of debt from other foreign loans? Third, the severe economic crisis that occurred in Sri Lanka in 2022 reinforced speculation about the debt burden from foreign loans and China. Although China has long been involved in Sri Lanka's economy, the BRI period saw a major expansion in that activity. China has provided loans for infrastructure projects, like as the 2007 start of the Hambantota Port's construction. China was granted authority over the port in 2017 when the Sri Lankan government gave China a 99-year lease of the port due to issues in repaying the loans. But it's apparently empty, with no flights or patrons, at the Chinese-built airport and eateries in Sri Lanka. In 2022, the economic crisis in Sri Lanka was marked by rapidly increasing prices, limited availability of food and gasoline, and declining foreign exchange reserves. Street demonstrations and public unrest around the country caused former President Gotabaya Rajapaksa to quit. A state of emergency being declared Debt trap diplomacy, in which loans are given to nations with unclear financial returns and subsequently result in a debt crisis, has been condemned by the Chinese government (He, William, 2022).

Fourth, most of the funding provided by China to Sri Lanka is in the form of loans, not grants, which undoubtedly only adds to Sri Lanka's burden of debt to be repaid (Wignaraja, et al., 2020). Furthermore, there are Geopolitical Concerns, where China's indifference to Sri Lanka's internal issue, which is the civil war, the war between the Sinhalese and Tamils, allows China to seize opportunities to expand its influence in the South Asian region, where India is the middle power there. Consequently, all of this leads to Sri Lanka falling into the China's debt trap, exacerbated by poor governance during Rajapaksa's administration in Sri Lanka, resulting in a high debt burden that triggered an economic crisis in Sri Lanka in 2022.

Debt trap is a highly sensitive issue and it is crucial to follow up on, considering that the debt trap itself threatens the security, sovereignty, and economy of a country. Sri Lanka, as one of the developing countries in the Asian region and also a crucial maritime silk road, becomes a concern for the author to further explore the debt trap created by China's Belt and Road Initiative (BRI) through this research. By thoroughly examining the factors leading to Sri Lanka's entrapment in the Chinese BRI debt trap, including the historical backdrop of its debt accumulation and the influence of internal conflicts such as the Sri Lankan Civil War, this research seeks to shed light on the implications and repercussions for Sri Lanka and its regional dynamics. Furthermore, by scrutinizing the role of populist leadership, exemplified by Mahinda Rajapaksa's era, in shaping Sri Lanka's involvement in BRI projects and its impact on both Sri Lanka and India as a middle power in South Asia, this study aims to contribute to a deeper understanding of the

complexities surrounding debt traps and their implications for geopolitics and economic development in the region.

## **1.2. Research Questions**

The Belt and Road Initiative (BRI) is a massive infrastructure development project launched by China in 2013, aimed at enhancing global connectivity through the infrastructure projects across Asia, Africa, and Europe. However, the BRI has been criticized for potentially creating a "debt trap" for participating countries, particularly those with weak governance structures. As the main part of this research, the researcher chooses the case study of Sri Lanka as one of the participating countries that could not be able to repay Chinese loans led to the handover of the strategically located Hambantota port to a Chinese operator in 2017.

This event has been cited as an example of China's debt trap with critics arguing that China has taken over indebted developing countries' infrastructure under a debt trap. However, there are also counterarguments that Chinese investments can be beneficial for developing countries, as they often involve infrastructure development and can help countries overcome economic challenges and also argue that the concept of a "debt trap" is overestimated and that the Chinese government is not intentionally trying to trap countries in unsustainable debt. The debate surrounding the BRI's impact on Sri Lanka and other countries highlights the need for a nuanced understanding of the role of Chinese investments in global development and its implications for sovereign debt governance. It also raises questions about the nature of Chinese intentions and the potential consequences of

creating the debt trap in the developing countries. Thus, this research is going to examine how China's BRI project create the debt trap in Sri Lanka through the following research questions:

1. What are the factors that lead Sri Lanka fallen into the debt trap situation?
2. What are the key factors and policy measures necessary for Sri Lanka to enhance transparency, governance, and accountability in their effort to handle the debt trap situation?

### **1.3. Research Objectives**

Regarding the focus of the research questions which is the BRI's debt trap in Sri Lanka, Sri Lanka's debt trap situation can be attributed to a combination of factors, including the country's heavy reliance on external financing, structural economic weaknesses, the terms of the loans provided by China under the BRI and the weak of governance. The country's debt burden has increased significantly due to large-scale infrastructure projects, many of which have been financed by Chinese loans with high interest rates and short repayment periods. As the author, I need to know these factors because by understanding the factors, it can develop policy recommendations to avoid similar situations in the future. These factors are very important and I will later use them to analyze and find a definitive answer to the debt situation in Sri Lanka. So, the objective is to identify and analyze the key factors that have contributed to Sri Lanka's current debt trap situation. In accordance with the title of this research, to say that Sri Lanka has fallen into the BRI debt trap, I must first find the factors that cause it so that the analysis produced

is also correct and the explanation given is more comprehensive. By elaborating on these objectives, I can clearly articulate why it is important to understand the factors that caused Sri Lanka to fall into the BRI debt trap. Each objective ties back to my research question, ensuring that my investigation is focused and relevant. This approach not only justifies the need to explore these factors but also sets the stage for a comprehensive analysis that can inform both academic discourse and practical policy-making.

In order to handle the debt trap situation, Sri Lanka needs to enhance its transparency, governance, and accountability. Sri Lanka also needs to implement several key policy measures. These include improving budget transparency and accountability, strengthening public financial management systems, creating a good governance and decision-making processes. If not addressed, Sri Lanka's debt trap situation could also undermine the credibility of the BRI and contribute to a perception of China as a predatory lender. To improve the debt sustainability and economic stability of Sri Lanka, it is essential to address the root causes of the debt trap situation. To design effective recovery strategies, it's necessary to identify the key factors that contributed to Sri Lanka's debt trap. By understanding these factors, I can develop targeted interventions that address the root causes of the debt crisis. This ensures that recovery strategies are comprehensive and tailored to the specific challenges faced by the country. Therefore, this research will analyze how the BRI project create the debt trap in Sri Lanka and identify the key factors affecting transparency, governance, and accountability in handling such issues.

#### **1.4. Research Significance**

This research seeks to undertake a rigorous and nuanced examination of the BRI project in Sri Lanka with a specific focus on the debt-trap of the Belt and Road Initiative (BRI) projects within the country. By addressing the complexities of these issues, the researcher aims to shed light on the impact of the BRI itself for Sri Lanka's economy, sovereignty, and its relationship with China. This research also expected to give the contributions in the academic significance especially International Relations field, to enrich the knowledge about the importance of having a good governance system to guard against falling into debt trap, especially for small or developing countries. Furthermore, this research is also expected to serve as a valuable case study for other countries facing similar debt challenges in the context of the BRI, allowing them to learn from Sri Lanka's experience and take steps to mitigate the risks associated with external financing and large-scale infrastructure projects. Thus, it will contribute to the existing knowledge on the debt trap situation in Sri Lanka, provide insights into the broader implications of the BRI.

#### **1.5. Thesis Outline**

The thesis outline in this research serves as a structured framework aimed at enhancing comprehension of the discussed subjects. This research begins with the abstract and it is segmented into six chapters, each meticulously crafted to delve into various facets of the topic. The chapters are delineated as follows:

The introduction of this research provides an extensive overview, setting the stage by discussing the background, research questions, objectives, and research



significance, alongside the thesis outline. It begins with a detailed examination of Sri Lanka, highlighting its descent into the debt trap resulting from the China's Belt and Road Initiative (BRI) project. The introduction also delves into the historical context of Sri Lanka, covering its formation, geography, population, and pre-independence history to facilitate a comprehensive analysis. It further explores the origins of the BRI and how it established cooperation with Sri Lanka.

The theoretical framework offers a broad literature review, starting with the BRI's impact on South Asia and the Indo-Pacific Region, and then focusing on the BRI's implications in Sri Lanka, particularly the debt trap. This section also examines previous research, identifying gaps that this study seeks to fill using the concepts and elements of Neorealism. It serves as the conceptual foundation guiding the analysis and interpretation of the findings.

In the research methodology chapter, the design and process of data analysis are detailed, covering the research approach, research method, data collection techniques, and data analysis techniques. This research employs a qualitative approach and a case study method, relying on secondary data sources such as library research, published academic papers, statistical data from government websites, reports, and social media data, with qualitative analysis used for data interpretation.

The result and discussion are in chapter 4 and 5. These chapters present the findings and analyses. The first part discusses China's BRI broadly and its specific implementation in Sri Lanka, including the debt trap mechanism. The subsequent chapter which is in chapter 5, focuses on Sri Lankan government policies towards

China and policy measures to enhance transparency, governance, and accountability in managing the debt situation in Sri Lanka. It also examines the role of international organizations and donors in supporting debt sustainability in Sri Lanka.

Finally, the conclusion succinctly summarizes the key findings and insights of the research, linking the Neorealism theory to China's motivations for the BRI and the resultant debt trap situation in Sri Lanka.

