

THE ISLAND OF THE LION
AND
THE LAND OF THE DRAGON
ESSAYS ON SRI LANKA – CHINA RELATIONS

**THE ISLAND OF THE LION AND THE LAND OF THE DRAGON
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ISBN 978-955-1201-07-4

1st Edition November 2017

Printed By

Softwave Printing and Packaging (Pvt.) Ltd
107 D, Havelock Road, Colombo 05.

The island of the lion and the land of the dragon : essays on Sri Lanka– China relations /

ed. H. M. G. S. Palihakkara. - Colombo : Pathfinder Foundation, 2017.
150 p. : ill. ; 21 cm..

ISBN 978-955-1201-07-4

i. 327.5493051 DDC 23

ii. Palihakkara, H. M. G. S. (ed.)

1. Sri Lanka – Foreign relations – China

3. Diplomatic relations – Sri Lanka

2. China – Foreign relations – Sri Lanka

4. Diplomatic relations – China

THE ISLAND OF THE LION AND THE LAND OF THE DRAGON

ESSAYS ON SRI LANKA – CHINA RELATIONS

PREFACE

Some 16 centuries ago, monks from the Land of the Dragon, schooled to venerate wisdom, set out across deserts and swollen rivers, forests and icy mountains, to learn at first hand the teachings of an Indian sage that they judged to be incomparable: the teachings of the Buddha Sakhyamuni. When they reached the land of his birth, the visitors were advised to travel south to the island kingdom of Sri Lanka, the land of a people said to have been fathered by a lion, where the Buddha's pristine teachings were venerated and preserved.

And so it was, that from the Fourth Century of the Common Era, people from the Land of the Dragon became acquainted with the people of the Island of the Lion, in pursuit of the true teachings of the Buddha Sakhyamuni. Visits by monks and scholars from China became more frequent because of what, as they described it, were the beauty of the landscape, the stately Buddhist architecture, the pleasant climate, the friendly disposition of the people, and the dedication of the rulers to maintaining the welfare of their people.

Embassies were dispatched to China by the Kings of Sri Lanka from about the Fifth Century of the Common Era, and a lively trade developed in precious stones, pearls and spices. With the conquest of the whole of Sri Lanka by the British and the banishment of the King by the British in 1815, the conduct of the country's foreign relations passed to the British Government, until Sri Lanka regained its independence in 1948.

More than a thousand years after those early contacts between our peoples which had roots in a spiritual affinity and longing, economic needs sparked a thoroughly modern alliance between our countries: an international treaty whereby Sri Lanka would export natural rubber to China and in turn China would export rice to Sri Lanka.

This year we celebrate the signing of the so-called “Rubber-Rice Pact” of 18, December 1952, and the renewal of diplomatic ties between our countries on 7, February 1957, marking for each in different ways periods of excessive foreign influence which both countries had long endured.

As a contribution towards the celebrations connected with the 60th anniversary of the re-establishment of diplomatic relations between Sri Lanka and China and the 65th anniversary of the “Rubber-Rice Pact”, the Pathfinder Foundation & the China Institute of Contemporary International Relations (CICIR) are happy to present this collection of essays dealing with different facets of Sri Lanka-China Relations.

We would also like to express our appreciation to the eminent personalities from Sri Lanka and China who contributed essays to the volume, and to Luxman Siriwardena, Executive Director - Pathfinder Foundation and Dr Li Li, Senior Fellow and Deputy Director Institute of South and Southeast Asia and Oceanian Studies China Institutes of Contemporary International Relations (CICIR) for coordinating the project. We offer our special thanks to Ambassador H.M.G.S. Palihakkara for functioning as the Editor.

Milinda Moragoda
Founder
The Pathfinder Foundation

Ji Zhiye
President
China Institutes of
Contemporary
International Relations
(CICIR)

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FOREWORD

The Cold War and its aftermath were marked by interesting contrasts as well as parallels. Only history will tell us if the risk of bipolar nuclear conflict of the Cold War was more or less dangerous than the reality of the widespread non-nuclear armed conflict and nuclear proliferation of the post-cold war period. The latter of course happened and will happen among States as well as non-state actors. The nuclear aspirant States include rich and poor as well as democratic and undemocratic ones. The wanton assault on our finite resources, especially the non-renewables and on our ecological life support system in the name of a 'good life' for those who can afford it, has made life untenable and unsustainable for many. Globalisation has swept the world. It has brought about breath-taking progress in many areas for many people. It is nevertheless, alleged to be responsible for marginalizing many vulnerable populations. Economists are already talking about 'de-globalisation'. In seeking greater good and wellbeing for their peoples, some nations and even continents had integrated into Unions blurring the hitherto sacrosanct attributes of sovereignty and nationhood. Some of these 'advanced' Nations now seem to experience countervailing waves of nationalism and even exclusion as was evident in the Brexit affair and in some elections in the Americas and Europe. There are also untenable and unsustainable contradictions like the quest for opening borders for goods and services while closing them for people, especially for those in distress. Commentators' question whether the constructive idea of liberal democracy is ending and disruptive populism is rising across nations and continents? Strategic power centres, financial prowess and production capacities have shifted from the Atlantic to the Asia-Pacific.

In this complex situation of change and volatility, one constant that stood out has been the rising power of China. The former German Foreign Minister Joschka Fischer commenting on the impending ‘Trump era’ laments the ending of what is known as ‘the (trans-Atlantic) West’ led by the United States. He bemoans the probability that China will ‘fill this gap’.⁽¹⁾

The cause and effect of this change and volatility is of course the subject of wide ranging debates that are on-going. What is beyond debate is the ascendancy of what the United States Admiral Harry Harris called the ‘Indo–Asia–Pacific Region’ in general and the ‘Sino-Indian’ power in particular.⁽²⁾ The region the Admiral referred to has some remarkable attributes. Its key players India and China, especially China will have the lion’s share of the world GDP totalling trillions of dollars; possibly the largest middle-class population; the largest purchasing power/production capacity and possibly the largest capital export potential in the world. Henry Kissinger’s words several decades ago and long before Joschka Fischer’s pronouncement were therefore not surprising. ‘Given a decent system, China with 800 million workers will provide world leadership’ Kissinger said.⁽³⁾

With Deng Xiaoping inspired reforms, what China has progressively and meticulously built up turns out to be quite a ‘decent system’ indeed. The country now has nearly double the population that Kissinger was talking about. No single country in recent times has alleviated poverty of so many in so short a time as China has. Given their formidable capacity to produce and consume as well as to create and export, China and India hold ‘decisive stakes’ in sustainable global growth and development. That of course requires secure and well serviced East-West trade routes including Sea Lines of Communication (SLOCs).

Has Sri Lanka, located as it is at a strategic pivot on this trade route, prudently and optimally exploited the national interest benefits that we

can derive from this enormous potential ‘to produce and consume’, especially by these two giant economies? Some analysts have also speculated on ‘Sri Lanka’s quest for strategic prominence in the Indian Ocean’ and the possibility of ‘carving out a role for itself (Sri Lanka) among the South Asian Littorals’.⁽⁴⁾ The challenge for Sri Lankan diplomacy has been and will be to show that we are after commercial/economic benefits and not strategic manipulation and that Sri Lanka will aggressively exploit the full investment and trading potential of the ‘Belt/Road’ initiatives of China for that purpose. In doing so, rather than having demarcated ‘zones for investing powers’, the whole of Sri Lanka can become a venue supporting multinational investment and multilateral cooperation for growth and development, without ruffling geopolitical feathers of anyone, regional or extra regional. Thus, the country will not be the ground zero for a ‘zero sum’ strategic power play that could give rise to the doomsday scenario of the kind conceived in the latest ‘geopolitical flourish’ from the Indian analytics industry viz. the possibility of Sri Lanka becoming a (hostile) ‘aircraft carrier parked just fourteen miles off the coast of India’.⁽⁵⁾

The Belt/Road potential can of course be projected and used as an opportunity for everyone and a threat to no one. The initiative straddles such a large economic space and is home to some of the largest economic power houses in the world; it has room for all the key players provided the playing field is levelled through diplomacy based on the force of rule rather than the rule of force. Continuous sabre rattling over the South China Sea is not an auspicious beginning though.

Despite the fact that China and Sri Lanka have deepened and widened their relations building on ‘the everlasting friendship’, to a platform of ‘strategic cooperation’, critics say that the former Government in Sri Lanka had unwisely placed most, if not all of their ‘eggs in the Chinese basket’ entailing serious debt management issues at home and troubling strategic concerns abroad involving India and the

US. The current Government got its share of criticism for the ‘clumsy handling’ of relations with China at the outset of its tenure. The new Government appeared too pre-occupied with making ‘course corrections’ to Sri Lanka’s relations with the United States and India that became sour during its predecessor’s tenure. The Government has since embarked on what seemed to be successful diplomatic negotiations to iron out differences with China, especially with regard to two key projects—the Port City and Hambantota. But residual irritants continued to linger.

Another ‘unconventional’ facet in this interesting phase of Sino-Sri Lanka relations had been the way in which the two major parties in Sri Lanka had used or ‘misused’ the real or contrived state of Chinese assistance and bilateral relations in what was a bruising election campaign early this year. This contrasts with a long-standing Sri Lankan tradition of working towards a bipartisan foreign policy, so that foreign relations do not get enmeshed in local politics which is an enterprise where no quarter is usually given. Since of late, this important principle seemed to have wilted against political expedience. Perhaps in reciprocity, China on its part also resorted to rather aggressive ‘public diplomacy’ in Sri Lanka in order to justify/explain its position on the nature of the so-called controversial projects and on the terms and conditions of the assistance provided. That too was an unprecedented step in the usually discreet Chinese diplomatic practice, especially with a country like Sri Lanka, who is supposed to be an ‘all-weather friend’.

It is in this context that the present collection of essays dealing with China–Sri Lanka relations focus on a broad range of challenges and opportunities the two countries are faced with. The authors include academics, researchers, diplomats and senior officials from Sri Lanka and China, who have had close association with the issues at hand or the relevant policy processes. The essays bring out some interesting contrasts. Sri Lankan side seems to be still grappling with residual politics of issues thrown up by the last election campaign in the country, while the Chinese

side is eager to bring out real life business matters beneficial to both side e.g. shifting the excess industrial capacity in China to Sri Lanka, help Sri Lanka to link up with global value chains exploiting the comparative advantage of the two countries in a complementary manner through the Belt/Road process. These points to hard-nosed business advice to the Sri Lankan Government as well as to our private sector regarding clear and present opportunities, which we have yet to seize fully. The Chinese authors also have no qualms about being blunt on the need for China to project power and create ‘front power centres’ in the Indian Ocean region in order to protect Chinese ‘citizens and properties’. While China takes a ‘considered’ note of the Indian perceptions about its ‘sphere of influence’, it dismisses as baseless, the Indian fears that China is up to ‘strategic mischief’ in Sri Lanka.

Given the complex and constantly shifting dynamics of the Indo-China-Pacific ascendancy and the pivotal roles of China and India therein, as well as Sri Lanka’s own long-standing but complex relationship with these countries, it would indeed be quite a taxing task to address the many dimensions of the challenges, let alone find solutions to them. However, the comprehensive and well researched essays will certainly help illuminate the issues and choices.

HMGS Palihakkara

Former Foreign Secretary and Ambassador of Sri Lanka.

- (1) (www.project-syndicate.org/commentary/goodbye-to-american-
- (2) (<http://www.slguardian.org/2016/11/defence-we-will-work-together-us-navy/>
- (3) ([/www.goodreads.com/work/quotes/14211568-on-china](http://www.goodreads.com/work/quotes/14211568-on-china))
- (4) (The Galle Dialogue, Abhijit Singh, <http://thediplomat.com/2016/12/sri-lankas-quest-for-strategic-prominence->)
- (5) Choices: Inside the making of India’s Foreign Policy (Geopolitics in the 21st Century), Shivshankar Menon

THE RELATIONS BETWEEN SRI LANKA AND CHINA FROM HAN DYNASTY TO THE PRESENT

*Ven. Prof. Nedalagamuwe Dhammadinna Thero**

Introduction

After the civil war that followed by the death of *Qin Shihuang* (259 BC –210 BC) in 210 BC, China was reunited under the rule of the *Han* dynasty, which is divided into two major periods: the Western *Han* (206 BC–9 AD) and the Eastern *Han* (25–220 AD).



Qin Shihuang

**Senior Lecturer in Chinese Studies, Director (Sri Lanka) of Confucius Institute, University of Kelaniya, Sri Lanka.*

The *Han* dynasty is considered a golden era in Chinese history. Because of its significant influence to the present, China's majority ethnic group refers to itself as the "*Han* people" and Chinese logographic letters are called as "*Han characters*". *Han* dynasty was founded by therebel leader *Liu Bang*, later known as Emperor *Han Gaozu*.



Han Gaozu

Arrival of Buddhism into China

Although there are certain reports of Buddhism in China as early as the 3rd century BC, Buddhism was not actively propagated in the country until the *Han* period. Buddhism was introduced during the period of Emperor *Han Mingti* (57-76 AD). The Emperor had a dream of a flying golden deity that was interpreted as a vision of the Buddha. Accordingly, the Emperor dispatched emissaries to India who subsequently returned to China with 42 chapters of Buddhist *Sutras*.



Han Mingti

Fei Changfang, a famous Chinese Buddhist scholar had composed one of his historical works, *Lidai sanbao ji* (Historical Records of the Triple Gem) in 597 AD. In this book, he recorded some of the significant Buddhist events that occurred in China, such as detailed records of the very first Buddhist missionaries to China, the places where they resided and their translations of Buddhist *Sutras* into Chinese. Some important matters the book records regarding the very first Buddhist missionaries and later developments of Buddhism in China are as follows,

“Fourteen people including *Jin Jing* - an official of *Yuling* and *Wang Cun* - a scholar of philosophy took off for *Sindhu*. When the delegation reached *Kushana*, they came across a monk known as *Kashyapa Matanga*. They have copied 42 chapters of Buddhist *Sutras* and have collected figures of the Buddha. They brought with them a white horse carrying Buddhist *Sutras* and figures of the Buddha on horse-back to the capital, *Luo Yang*. A temple named *Bai ma si* (White Horse temple) was built to pay respect to the White Horse. The old foundation of the White Horse temple is located 200 feet away from the south side of the new temple in *Ching men* street of the *Chang an* city. At the archives

named *Lan tai shi*, 42 chapters of Buddhist *Sutras* were translated into Chinese from which the doctrine of *Shakyamuni* begun to spread. Also, there were many monks and educated laymen continuously involved in translation.”¹

Ancient Chinese Names of Sri Lanka

“In Chinese sources dating from the *Han* dynasty (206 BC – 220 AD) to the *Qing* dynasty (1616-1911AD) alone, more than thirty names have been used to denote Sri Lanka.”²

Sri Lanka was one of last stops for Chinese navigators in the *Han* period as *Han Shu* mentioned.³ At that time, it used the term of *Sichengbu* for Sri Lanka,⁴ which can be identified as *Sinhadipa*, one of the ancient names of Sri Lanka. The object of the mission of Chinese navigators was to ‘spread the power and virtue’ of the *Han* Emperor and ‘search for precious objects’. The second name for Sri Lanka, which was used in Chinese primary sources, was ‘*Si diao guo*’ or ‘*Si diao zhou*’. This name was probably another transcription of *Sihadipa* or *Simhadvipa*. The Chinese book called ‘*Kang tai wu shi wai guo zhuan*’ reports that pearls embedded cloth and golden bed were sent to a Buddhist temple in India from *Si diao guo*. The book also reports in the bay of *Si tiao zhou* there was salt like small stones, people used to collect them there. The Chinese source ‘*Nan zhou yi wu zhi*’ mentions that *si diao guo* is situated in the middle of the sea and it is a very fertile country with many towns and streets. The book ‘*Guang Zhi*’ mentions *si diao guo* is the name of one of the countries which has the most valuable gems.

1 《历代三宝记·卷第四》CBETA电子佛典系列（CD），中华电子佛典协会，台湾

2 Sobhitha, M., Names of Sri Lanka as Revealed through Ancient Chinese Sources, <http://www.pdn.ac.lk/purse/Proceedings/2011/hch/hch8.pdf>

3 “黄支之南，有已程不国，汉之译使自此还矣。”《汉书·地理志》

4 《汉书·地理志》

Later on, in 131, 414, 428, 435, 455, 527, 670, 712, 742, 746, 750, 762, and 989 AD thirteen missions were sent to China by Sri Lankan kings of *Anuradhapura* according to the Chinese sources. It can be argued that some of these missions were of a purely religious nature but undoubtedly their objective was also to establish cordial political relations aimed at securing greater trade contacts between Sri Lanka and China.

The most common name used to identify Sri Lanka in Chinese sources was '*Shi zi guo*'. The term means 'Lion country' in Chinese. This was used for the first time during the *Jin* Dynasty (265-429 AD). According to '*Gao seng Chuan*' (Biography of Eminent Monks), a mission arrived in China from '*Shi zi guo*' before *Bhikkhu Fa Xian* left China to collect Buddhist books. *Bhikkhu Fa Xian*, who visited Sri Lanka in the fifth century, also used this name for Sri Lanka. The name of '*Shi zi guo*' was used in Chinese sources from the *Jin* to the *Song* dynasty (960-1279 AD). There are some variations of '*Shi zi guo*' also in some other Chinese primary sources. '*Yuan shu*', the Dynastic history of the *Yuan* Dynasty (1271-1368 AD) also used '*Shi zi guo*' with a different Chinese character for '*Shi*'. *Bhikkhu Xuan Zang's* '*Ta tang xi you ji*', Great Tang Records on the Western Regions and '*Gao Seng Zhuan*' called Sri Lanka as '*Zhi shizi guo*'. Another Chinese pilgrim, *Bhikkhu Yi Jing* in his work '*Ta tang xi yu qiu fa gao seng zhuan*', The Great Tang Biographies of Eminent Monks who Sought Dharma in the Western Regions used '*shi zi zhou*'.

Sino-Lanka Buddhist Relations

As records indicate *Bhikkhu Fa Xian* arrived in Sri Lanka in 411 AD, which according to Sri Lankan chronicles falls within the reign of King *Mahanama* (406-429 AD). He also called Sri Lanka as '*Shi zi guo*'. *Jin Shu* and *Liang Shu* of Chinese historical records state that the King of *Sihaladipa*, having heard of Emperor *Xiaowu* in Eastern *Jin* Dynasty

(373-396 AD) believe in Buddhism, sent a monk named *Dharma* with a Jade Buddha Statute to *Nanjing*, the capital of *Jin*, through 10 years voyage on ocean. The Sri Lankan king who sent the mission has been identified as king *Upatissa I* (365-406 AD), king *Mahanama*'s brother and predecessor. Religious relations with China would have got strengthened with the arrival here of *Bhikkhu Fa Xian*.



Bhikkhu Fa Xian

King *Mahanama* himself sent another mission to China in the year 428 AD. As Chinese records indicate the gifts he sent to the Chinese Emperor included two pieces of muslin, a product Sri Lanka was famous for at the time. The most important religious gift he sent was a replica of the Tooth Relic, a fact that signifies the respect the relics commanded in Sri Lanka as well as China. Another event of great religious significance was the sending of two *Bhikkhuni* missions during the closing years of *Mahanama*'s reign and establishing the *Bhikkhuni* order in China.

As Chinese sources indicate in the 5th century AD, the *Bhikkhuni* ordination was taken by Sri Lankan nuns headed by *Bhikkhuni Tie Saluo* (*Disala or Devasara*) to China in the capital of *Nanjing*. They traveled in sailing ships crossing dangerous seas for three months along the silk route in a merchant ship of a man called *Nandi*. Thus the Sri Lankan *Bhikkhuni* ordination was established in China. There is significant evidence to prove that *Nandi* was also a Sri Lankan merchant who had close relations with the Chinese. In 429 AD, Sri Lankan nuns headed by *Tie Saluo* reached China. They stayed at *Jing Fu* temple in *Nanjing* hosted by Chinese nuns such as *Hui Guo* and *Jing Yin*. They needed at least ten nuns to establish *Bhikkhuni* ordination. *Nandi* did not give up their obligations, five years later he brought another eleven nuns to China. It is said that *Bhikkhuni Tie Saluo* studied Chinese well within a period of five years, with other Sri Lankan nuns she ordained more than three hundred Chinese nuns in *Nanlin* temple at *Nanjing*.

“Exchange of Embassies between the Sinhalese and the Chinese continued to take place during the seventh and eight centuries too. In fact contact with Sri Lanka was constant and a Chinese text mentions the visit to Sri Lanka of a learned Indian monk of princely status called *Vajrabodhi* 718/798.”⁵

Sino-Lanka Relations in Medieval Period

Archaeological evidence in Sri Lanka proves that the China and Sri Lanka had enjoyed continued trade relations during the period of ancient Silk Road. Chinese ceramic remains, coins, glazed remains and Chinese inscriptions found in some of the ancient ports provide valuable information and acceptable proof of evidence that there had been trade

5 B.E.S.J. Bastiampillai, CHINA-SRI LANKA: TRADE AND DIPLOMATIC RELATIONS INCLUDING THE VOYAGES OF CHENG-HO

relations between Sri Lanka and China beyond the Christian era. It is recorded that from 1235 to 1270 AD, Chinese soldiers formed a part of the Sri Lankan army to meet the threat to the country's sovereignty.

In the thirteenth century, the Chinese Emperor also initiated several missions to Sri Lanka. The *Mongols* in China, who assumed *Yuan* dynasty, dispatched four missions to Sri Lanka, all of them during the reign of Emperor *Kublai Khan* (1260-1294 AD) in the years 1273, 1284, 1291, and 1293 AD. The foreign policy of emperor *Kublai Khan* and the greater Chinese interest in foreign trade were perhaps the key compulsions for initiating these missions. The only Sri Lankan mission to *Yuan* court was sent in 1293 AD during the reign of Sri Lankan king *Parakramabahu III*. Subsequently, under the *Ming* Dynasty (1368-1644 AD) Sri Lanka became one of the focal points of attention during the well-known maritime expeditions of *Zheng He*. In one of *Zheng He's* Sri Lankan visits in 1411-12 AD he encountered hostilities from the nobility in the capital, *Kotte*, but he retaliated in a later visit which resulted in the enthronement of a king (*Alakeshvara?*) of Sri Lanka. However, the crisis was solved by the Chinese Emperor graciously permitting the captives' release and safe return to their country. Later on, there were exchanges of missions between the king of *Kotte*, *Parakramabahu VI*, and Chinese Emperors in 1416, 1421, 1430, 1433, 1436, and 1459 AD. *Ma Huan*, an officer of *Zheng He* recorded some facts regarding Sri Lanka in his journal.



Zheng He

The Colonial period of Sri Lanka is dated from the first *Portuguese* settlement in Ceylon, in 1505, until Sri Lanka achieved independence in 1948. The number of Chinese people who were living in Sri Lanka increased rapidly when the European nations colonized this country.

During the early years of the *Dutch* colonization in Indonesia, many people of Chinese descent were contracted as skilled workers in the construction of *Batavia*. The economic boom also increased Chinese immigration to *Java*. The Chinese were growing in number and their wealth was increasingly visible to local authority of *Dutch East Indies*. As a result, in 1740, Chinese who were considered as suspicious would be deported to Ceylon and were forced to harvest cinnamon.

Frederick North, a British Governor of Ceylon also had pursued the idea of securing foreign labour as a work force and he was able get down 47 Chinese. He settled them in *Galle* and *Trincomalee*. Governor *Maitland*, too, followed the same policy and got down 100 Chinese to reconstruct the *Hamilton Canal*. The name *Ja-Ela* is a memento from this period when the ordinary people mistook the Chinese from *Penang* to be *Malays*. The *China Garden* or *Cheena Koratuwa* in *Galle* is where the Chinese were settled.

Modern Relations between Sri Lanka and China

Both countries agreed to establish formal diplomatic relations in 1957. Sri Lanka and China signed significant agreements such as Sino-Lanka Rubber-Rice Pact (1952), First Agreement on Economic and Technological Cooperation (1962), Maritime agreement between China and Sri Lanka (1963), Sino-Lanka Joint Trade Committee (1982), Sino-Lanka Economic and Trade Cooperation Committee (1984), Sri Lanka-China Business Cooperation Council (1994).



Sri Lankan Chinese

On 31st October in 2008, Sri Lanka took the policy decision to grant the status of a Citizen of Sri Lanka to persons of Chinese Origin.⁶ Accordingly, the *Sri Lankan Chinese*, who were formerly stateless and have had permanent residence since November 15th in 1948, were granted citizenship under the 2008 “Grant of Citizenship to Persons of

6 <http://www.srilankalaw.lk/Volume-III/grant-of-citizenship-to-persons-of-chinese-origin-special-provisions-act.html>

Chinese Origin (Special Provisions) Act”.⁷ These *Sri Lankan Chinese* were either born in Sri Lanka or had come to Sri Lanka with their parents at a very young age. Most of these immigrants are already Sinhala - fluent though some of them are bilingual in Sinhala and English in the oral form. Thus it is not difficult to find the roots of the Chinese who have been living in Sri Lanka and appreciate their contributions to nation building throughout the centuries. However, according to some sources, the Sri Lankan Chinese were not able to inculcate the Chinese language as their mother tongue in the new generation. They forgot their native Chinese and adapted into local languages.

7 The act further says that “Any person of Chinese origin, who —(a) has been a permanent resident of Sri Lanka, since November 15, 1948; (b) is a descendent. Presently resident in Sri Lanka, of a person who has been a permanent resident of Sri Lanka since November 15, 1948.shall be entitled to apply in terms of the provisions of this Act, for the grant of the status of a “Citizen of Sri Lanka”.

SRI LANKA'S POLICY TOWARDS CHINA: MUTUAL PERCEPTIONS

*Amb Bernard Goonetilleke**

1. Historical Relations Driving Contemporary Policy

Historical records corroborate that China-Sri Lanka relations date back to the pre-Christian era. In fact, diplomatic relations between the two countries go back to the reign of King Bhatika Abhaya (also known as Bhatika Tissa), 19 BC to 9 AD, during which period the first recorded diplomatic mission reached China by overland.⁸ Such diplomatic exchanges were regular until the arrival of Europeans to the island in the early 16th century, except for the period from the 8th to the 12th centuries. Historical records indicate that not less than 21 missions had visited China over the centuries since the first recorded mission up until 1459 AD, when the last diplomatic mission reached China.⁹

The *Chulavamsa* 1¹⁰, corroborates the account of Chinese pilgrim Fa-Hsian's visit to Si Lanka around 410 CE, that he included in '*A Record of the Buddhist Countries*', also known as *The Travels of Fa-Hsian*.¹¹ Fa-Hsian, who hailed from the ancient Chinese capital of Chang'an, stayed

**Chairman - Pathfinder Foundation, Former Secretary, Ministry of Foreign Affairs, Sri Lanka.*

8 Plini (24-79 AD, *Historia Naturalis* bk. vi. Ch. xxiv)

9 S G M Weerasinghe, *A History of the Cultural Relations Between Sri Lanka and China* P. 118

10 The *Mahavamsa*, Ch XXXVII, verses 228-30

11 *Ibid.* Ch. XXXVIII

at the Abhayagiri Temple complex in Anuradhapura during his sojourn in the island. He details how he became emotional upon seeing a silk fan presented by a Chinese merchant as an offering to Buddha.¹² This anecdote provides a glimpse of the strong religious, cultural and commercial relations between China and Sri Lanka at that time. The narrative also confirms connectivity between the two countries through ancient land and sea silk routes. It also appears that Chinese traders and pilgrims routinely travelled via Central Asia to India - sailed from the port of Tamralipti in Eastern India to Sri Lanka, and returned by ship to China via Sumatra (Yava Deepa).¹³

Likewise, ancient records also shed light to travel from ancient Sri Lanka to China. Approximately four years before Fa-Hsian's arrival, a Sri Lankan Buddhist priest named Dhammayana, took the first Buddha statue to China. In 433 CE, a Sinhala ship-owner named Nandi had provided transportation to eight Theravada bhikkunis from Sri Lanka to China.¹⁴ This group, led by Ayya Sara (a.k.a. Devasara or Pichuni-Chuang according to Chinese sources), established the Order of the Buddhist (Nuns) in China, in 439 CE, where it survives to this day. The fact, that Nandi had to make two trips to China to complete his mission signifies that travel between Sri Lanka and China had been regular occurrence.¹⁵

12 Suddenly (one day), when by the side of this image of jade, he saw a merchant presenting as his offering a fan of white silk; and the tears of sorrow involuntarily filled his eyes and fell down. Ch. XXXVIII (Translated by James Legge. ("<https://ebooks.adelaide.edu.au/f/fa-hien/f15l/chapter40.html>")

13 "After proceeding in this way for rather more than ninety days, they arrived at a country called Java-dvipa" Excerpt From: "A Record of Buddhistic Kingdoms." Ch. XL.

14 CDN 22 May 2010 <http://archives.dailynews.lk/2010/05/22/fea04.asp>

15 Sri Lanka's Role in the Spread of Buddhism in the World, Dr. Ananda Guruge. (<http://www.kusala.org/udharma14/srilankahistory.html>)

Along with the positive predictably there have also been negative interactions. Historical records in Sri Lanka¹⁶ refer to an acrimonious clash, resulting in King Vijaya Bahu been taken captive to China by Chinese Admiral Zheng He, after slaying his four younger brothers, during his third voyage (1409 -1411 CE) to the Indian Ocean.¹⁷ However, there is a school of thought that it was Alakeshvara of Kotte, who was taken captive by Admiral Zheng He.

These narratives, as well as the numerous names China had used to describe ancient Sri Lanka provide ample proof that relations between China and Sri Lanka go back over 16 centuries. The intercourse between the two countries was largely positive and covered a broad spectrum, from trade and commerce, to spread of Buddhism and the rich culture associated with it.

2. Formulation of Foreign Policy

A country's foreign policy is designed to facilitate cordial relations with the outside world, focusing on promoting and safeguarding national interest in all its dimensions political, socio economic or security. In that process, countries at times tend to develop alignments and special relations with a country or group of countries.

Ceylon became independent in the midst of a cold war between the West and the East, dominated by the USA and USSR, respectively. In the immediate aftermath of independence from 1948-1956, Ceylon, appears to have developed a pro-Western stance probably due to its colonial heritage and being part of the British Commonwealth. This pro-western position was brought into sharper relief by the activities of a group of

16 Rajavaliya P. 66

17 Dreyer, Edward L. (2007). *Zheng He: China and the Oceans in the Early Ming Dynasty, 1405-1433*. New York, NY: Pearson Longman.

Marxists including Trotskyists in Ceylon, who had their own radical view about the Western style parliamentary democracy and conducted their political maneuverings with revolutionary zeal.

There are other factors that contribute to a country's foreign policy. Sri Lanka's own history illustrates that changes in the ruling parties, heads of government etc. significantly influence the shaping of foreign policy. Contrasting policies adopted by the UNP and the SLFP administrations, particularly during the pre-1956 and post-1956 periods, demonstrate how regime changes affected the country's foreign policy, which is a factor even today.

3. Relations in Modern Times: Was it 'All Weather' All Times?

Close relations between China and Sri Lanka demonstrate an 'All Weather Friendship.' That description takes bilateral relations to 1949, the year the People's Republic of China (PRC) came into existence. Within months of that event, in January 1950, the newly independent 'Ceylon', extended diplomatic recognition to PRC.

Prior to 1977, the Prime Minister was charged with the task of conducting Sri Lanka's foreign relations as evidenced during the premierships of S.W.R.D. Bandaranaike and later Sirima Bandaranaike, as opposed to the presidency of J.R. Jayewardene. Looking at how Sri Lanka's policy towards China gradually evolved, it becomes clear that it was largely determined by the vicissitudes faced by the country in the economic, political and security spheres at different times in history.

Unlike in China, where the Communist Party remained at the helm throughout the modern period, in Sri Lanka the two main parties i.e. the United National Party (UNP) and the Sri Lanka Freedom Party

(SLFP), took turns in administering the country since independence. Irrespective of which party was in power, China made it a principle to maintain harmonious relations with the elected Government, while also maintaining its affiliation with the Ceylon Communist Party, which broke away in 1964 to establish the 'Peking Wing' under N. Shanmugathan. However, a warmer relationship between Beijing and Colombo was apparent, when the SLFP was in power.

4. China- Sri Lanka Economic Relations

At the time of independence in February 1948, Ceylon was an economically stable country. With a healthy balance of payments condition, the country was able to provide free education, free health facilities, and numerous subsidies to the population. However, this promising climate soon changed and the island began to be buffeted economically as well as politically. Depressed prices for primary products and the outbreak of the Korean War in June 1950 added to the economic difficulties faced by the country. Furthermore, the Government was unable to sustain the welfare state without making a serious dent in its treasury. By 1952, the situation was almost out of control due mainly to two significant, unanticipated events. S.W.R.D. Bandaranaike, a prominent Minister in the ruling UNP Government, broke ranks in 1951, to establish a new political party the Sri Lanka Freedom Party (SLFP), and Prime Minister D. S. Senanayake passed away suddenly in March 1952, resulting in a general election that year.

In December 1952, UNP signed the historical Rubber-Rice Agreement (RRA) with China, which is considered the hallmark of China-Sri Lanka relations. What prompted the Western-oriented UNP administration to embrace China derisively named as 'Red China' or 'Communist China' by the West and ignoring potential serious

consequences, is indicative of an emerging sophisticated foreign policy approach based on national interest, but it requires further study.

Delving into the history of newly independent Ceylon, it is clear that the decision was motivated by economic compulsions. By 1951, the island was heading for an economic catastrophe with the welfare state it created steadily draining the resources of the country, and commodity prices hitting rock bottom. An unexpected increase in the price of essential goods including rice, led to a public revolt, which was fanned by leftist trade unions, supported primarily by the Communist Party (CP) and the Lanka Samasamaja Party (LSSP), leading to a civil disobedient movement ('Hartal'). With the Korean War raging and PRC facing difficulties in sourcing rubber, a strategic commodity, the RRA signed in November 1952 by then Commerce Minister R. G. Senanayake on favourable terms to the island, was a blessing in disguise to the struggling government in Colombo. Observing the rampant volatile situation, it is clear that the bold decision the Commerce Minister took, despite objections from some of his colleagues in the Cabinet, particularly Finance Minister J. R. Jayewardene, was necessitated by dire economic circumstances. However, he had the full support of Prime Minister Dudley Senanayake, who dismissed the allegation of opening the door to communist influence by stating, "*Communism thrives in many places, not through an understanding of that particular ideology, but through poverty and want. I am confident that our Trade Agreement with China will, instead of opening doors to communism, help us to stand firmer against it*"¹⁸

It is noteworthy that Sri Lanka had also attempted to reach an agreement with the USA on rubber sales. However, those attempts were not reciprocated by Washington, which erroneously thought that

18 Kelegama 2002

Colombo's plan to sell rubber to China was not serious and that the Government was making an empty threat of reaching an understanding with China, with no intention of carrying it out. A top-secret telegram by the US Ambassador in Colombo to the US Department of State dated May 8, 1951, indicates that initial discussions between Colombo and Beijing had begun in early 1951, full 18 months before signing of the RRA, which demonstrates lack of understanding and appreciation of the situation by the US.¹⁹

The UNP government should be credited for its need-driven bold step. It is praiseworthy that the Government placed the national interest before its political affiliation with the West, and decided not to yield to the US pressure. Evidently Washington did not view that decision favorably. However, Colombo was not subjected to the UN General Assembly embargo resolution of May 18, 1951 against trade with China due to the fact its entry to the world body had been blocked by the USSR because of cold war considerations and Sri Lanka was denied assistance under the 'Point Four Programme' of President Harry Truman in terms of the US Battle Act of 1951, against those countries that had failed to prohibit export of strategic goods to Russia and its allies.

Colombo's apparent pro-China policy prompted Washington's unprecedented step of sending US Vice President Richard Nixon to Sri Lanka in November 1953. His discussion with Prime Minister Sir John Kotalawala revolved around "problems of mutual interest" for the two countries, which included the RRA and the consequent US embargo on assistance to Ceylon, resulting in an understanding on each other's positions on the subject.²⁰

19 Foreign Relations, 1951 Vol. VI - US Policy with respect to Ceylon.

20 Pre-Presidential Papers of Richard M. Nixon. Series 320, December 8, 1953.

With the election of S.W.R.D. Bandaranaike in 1956, bilateral relations between the two countries began to blossom. Relations continued to deepen and widen during the administrations of the SLFP in the periods 1956-1965, 1970-1977, 1994- 2001 and 2004-2015 with breaks in 1965 -1970, 1977-1994, and 2001-2004, when the UNP was the ruling party. Despite China remaining a developing country for several more decades, significant contributions were made by Beijing to further improve relations particularly from 1971 to 1977, during which period China also became the leading trading partner of Sri Lanka. When the administration of the SLFP headed by Prime Minister Sirima Bandaranaike assumed office, China offered to construct a conference hall in the memory of late Prime Minister S.W.R.D Bandaranaike, who established diplomatic relations with China. Furthermore, China inaugurated several other development projects including the Gin Ganga Flood Prevention scheme in 1975 that positively contributed to the economy.²¹

During the UNP administration 1965-1970, there were signs of souring relations demonstrated by misunderstandings over the import of Chairman Mao's souvenirs and shelving of the plans for the conference hall offered by China in memory of S.W.R.D. Bandaranaike. The 1977 general election witnessed a landslide victory for the UNP, with an unprecedented number of seats in parliament. This resulted in the introduction of a presidential system under J.R. Jayewardene and the relegation of Prime Minister Sirima Bandaranaike to political wilderness temporarily. President Jayewardene focused attention on introducing a free market economy to Sri Lanka, breaking away from the socialist mould and looked towards the West and Japan for economic support. In that process, Sri Lanka established the Greater Colombo Economic Commission (GCEC) in 1978, which saw a gradual inflow of foreign investment into the country.

21 Country Report 2003 – Sri Lanka.

This era coincides with the period when China was searching for a model to base reforms to its own economy. In its quest for a suitable model, China chose several countries for a study, and one choice was Sri Lanka. The Chinese delegation was warmly welcomed by Sri Lanka and given a free hand to observe and learn how GCEC was established, how its laws were formulated and how foreign investments were encouraged. Jiang Zemin, Vice Chairman of State Administration Commission on Foreign Investment, who led the delegation, became President of China in 1993, and headed the country for a full decade. The lesson to be learnt from this episode is that Beijing cared little about the regime change that displaced its ally Prime Minister Sirima Bandaranaike and brought J.R. Jayewardene to power, who was leaning to the West, particularly the USA. China was single minded in its desire to introduce economic reforms, and it did not matter who provided the requisite knowledge to make that transformation. This was a classic case of Deng Xiaoping's policy - "it does not matter whether the cat was white or black, so long as it catches mice!" Having introduced new economic policies in the early 1980s, China successfully transformed itself from a 'developing economy,' to the second largest economy in the world, within a short space of three and half decades!

By 2009, a momentous year for Sri Lanka's political history, China together with Hong Kong, had become the 13th largest destination for Sri Lanka's exports (\$151.2m), whereas jointly both entities had become the second largest source of imports (\$1937.1m). Where Foreign Direct Investment (FDI) was concerned, China was lagging behind Malaysia, India and the Netherlands.²² (Kelegama, China-Sri Lanka Economic Relations: An Overview Sept. 2009). It is noteworthy however, that by this time, China had given a considerable volume of economic assistance to Sri Lanka, which included the BMICH, the Nilambe Hydropower

22 Kelegama, China-Sri Lanka Economic Relations: An Overview Sept. 2009)

project, the Central Mail & Telegram Complex, the Supreme Court Complex, the Gin Ganga Flood Protection Project etc. In addition, several water supply and rural electrification projects were financed by Chinese grants or completed under technical assistance programmes (Kelegama Sept. 2009).

Sri Lanka battled an internal armed conflict up to 2009, which originated in the early 1980s. Consequently, there was little or no space for China to engage in high-level economic activity in the country. On the other hand, Sri Lanka had nothing tangible to offer Chinese companies seeking investment abroad during that period. Yet, despite the prevailing security situation, China signed an Approved Destination Status (ADS) agreement, granting Sri Lanka the status of a tourist destination in early 2000, which facilitated Chinese tour companies to include the island as a tourist destination. That decision facilitated China to become one of the largest tourist generating countries to Sri Lanka by 2015. Looking at the security situation prevailed in the country at that time, it is apparent that it was a political decision taken by Beijing to assist cash strapped Sri Lanka,

The end of the armed conflict saw a surge in Chinese funded economic activity, such as ports, airports, oil storage facilities, highways, rural electrification, railway, and construction of the National Performance Arts Theatre and the Puttalam Coal power project. Some of these were outright grants, while others were launched on credit lines. Among the important projects was the 'Colombo Port City' designed to reclaim app. 250 ha from the sea at a cost of \$1.4 billion, which would see post reclamation work valued in excess of \$ 15 billion, signed between Chinese President Xi Jinping and Sri Lankan President Mahinda Rajapaksa in September 2015. The project suffered a temporary setback following the electoral defeat of President Mahinda Rajapaksa. The ensuing situation, soured China-Sri Lanka relations considerably, stopped several development projects midway, affected the growth of Chinese

tourists visiting the island and virtually dried up Chinese investment in Sri Lanka, until the agreement was re-negotiated and signed in July 2016 by the new administration.

However, that temporary transformation of relations cannot be attributed to ideological or political differences with China. Suspension of the Colombo Port City Project (CPCP) by the UNP administration merits a separate study. Sufficient to say at this juncture, that the decision was primarily due to heavy external pressure and the expectation that the much-needed foreign investment would come from the West. Subsequent events proved the expectation of aid and investment was a mistaken belief and the new Government was forced to turn back to China to satisfy its demand for development projects. The experience of Prime Minister Wickremesinghe was not any different from that of President J. R. Jayewardene in 1977, who turned towards the West for development aid, investment and political support to the irritation of then anti-US India, only to be disappointed and to face a three decades long armed conflict nurtured by that country in retaliation for embracing open market economy and leaning towards the West.

Post-January 2016 general election developments confirm that the Government thus recalibrated its policy on China as demonstrated by the signing of a new agreement to re-launch the Colombo Port City Project with some modifications to the original agreement and a new name. Unable to free itself from the massive loan burden, the Government is taking steps to deliver two virtually defunct assets i.e. Mattala Airport and the Hambantota harbor to Chinese hands to the chagrin of India and the USA and casting an uncertain political and security cloud over Sri Lanka.

The Free Trade Agreement (FTA) currently under negotiation with China, would facilitate duty free access both ways, and provide

a platform for Chinese and Indian companies to use Sri Lanka as a manufacturing base to gain access to the two countries. Demonstrating China's future plans, during his visit to Colombo in July 2016, Chinese Foreign Minister Wang Yi assured that "China will be the most sincere, and the most reliable cooperative partner of Sri Lanka in its development process, and that China would help Sri Lanka to build a shipping center in the Indian Ocean".²³

Such statements made by high level Chinese political leaders signify their planned economic activity in Sri Lanka. It is evident that there is no other country that has resources to match China. Having gone through a three decades long armed conflict that has drained its economic strength, Sri Lanka requires heavy investment to stabilize and re-launch its economy, as well as to provide employment to its growing population of youth. Consequently, Sri Lanka has no option but to continue to rely on China for funding development projects and infusing foreign investment.

5. Political Relations

Establishment of Diplomatic Relations

The UNP administration, which courageously signed the RRA with China in 1952, was hesitant to go the extra mile to establish diplomatic relations with Beijing. However, it must be recalled that entry of Ceylon to the United Nations had been denied until December 1955, by the Soviet Union. In the context, it would not have been possible for Colombo to consider establishing diplomatic relations with the 'socialist bloc', headed by the USSR, as Beijing remained a close ally of Moscow until the split in their relations in 1956 due to ideological reasons. As such, it is evident that the time was not ripe for Colombo to decide on diplomatic relations with China prior to 1955.

23 (Chinese Embassy Press Release of 12 July 2016).

However, since the signing of the RRA, interested groups including the Buddhist clergy headed by Ven. Udakendawela Saranankara, Ven. Naththandiya Pannakara, Ven. Bambarende Siriseewali etc., conducted public demonstrations to force the government to establish diplomatic relations with China. While supporting their demand, Bandaranaike gave an assurance that if his party were to come to power, he would establish diplomatic relations with the socialist countries including China. He indeed made good of his pledge in February 1957, within 10 months of his election victory.

From the inception, Colombo had adopted a pragmatic policy with regard to its relations with Beijing. Despite being predominantly a Buddhist country, the Government sided with China when its armed forces entered Tibet in 1951 and signed a 17-point agreement. Moreover, Colombo supported China's 'One China' policy in respect of Taiwan, which remains effective to date. Further, Sri Lanka actively campaigned in favour of admitting the People's Republic of China to the United Nations replacing Taipei, and took the lead in that effort by co-sponsoring the UN resolution, (UNGA Res. 2758), the adoption of which, facilitated China to regain its rightful place in the world body. Finally, when the West accused China of violating human rights in the United Nations Commission on Human Rights (UNCHR), Sri Lanka unhesitatingly supported China and the latter reciprocated by supporting Sri Lanka on every occasion, when it faced difficulties on the human rights front in Geneva and when the issue of the military operations against the LTTE came up in the UN Security Council.

Among the highlights of China-Sri Lanka political relations are the visits by Premier Chou En Lai (1957 and 1964), Premier Li Peng (1990) and Premier Zhu Rongji (2001). The most momentous was the first ever visit by a Chinese President to Sri Lanka in September 2015, which resulted in signing 27 agreements aimed at cooperation in several fields. Highlighting the importance of bilateral relations, China also

signed a currency swap agreement with the Central Bank of Sri Lanka worth \$1.63 billion coinciding with President Xi Jinping's visit.

Similarly, there had been high political level visits from Sri Lanka to China including the visits by Prime Minister Sirima Bandaranaike in 1961 and 1972. Sri Lanka's standing in the emerging Non-Aligned Movement became evident by the nomination of Prime Minister Sirima Bandaranaike by 6 non-aligned countries to mediate between China and India during the border war in 1961. Since then, numerous Sri Lankan political leaders made regular visits to China including President J R. Jayewardene in 1984, President Chandrika Bandaranaike Kumaratunga, President Mahinda Rajapaksa, President Maitripala Sirisena and Prime Minister Ranil Wickremesinghe in April 2016. These high level visits to and from China enabled the two countries to further nurture decades long friendship and cooperation.

The narrative leading to China's decision to build a conference hall (BMICH) in memory of the late S.W.R.D Bandaranaike, during the second visit of Premier Chu En Lai in 1964, was sufficient to demonstrate the high esteem in which the late Prime Minister was held by China. Similarly, the decision taken by the Chinese authorities to send a specially chartered planeload of high-level representatives of the Government and the Communist Party to attend the funeral of Prime Minister Sirima Bandaranaike in October 2000 was another example of the close relationship she enjoyed with China for almost four decades. The reaction to the attack against Chinese fishing vessel Fuyuangyu 225 in March 2003²⁴ by the Liberation Tigers of Tamil Eelam (LTTE) killing 15 Chinese nationals and the response of the Chinese government to that episode, indicate restraint, maturity as well as the value it placed on China-Sri Lanka relations.

24 China Daily March 22, 2003)

The armed conflict, which surfaced in early 1980 and rose to a climax during early 2000, illustrates, how consistently China stood by its 'all weather' ally. In contrast, that era was also replete with examples of certain Western countries that just stood by and watched the mayhem created by the LTTE in the island. The LTTE also operated centres for fund raising, procurement of weapons and other military hardware in those countries, while authorities appeared to turn a blind eye. Until the assassination of former Prime Minister Rajiv Gandhi in 1991, there was competition between the ruling party and the Opposition in the State of Tamil Nadu for providing succor to the LTTE. While the US provided some military assistance to the Government, took legal action against the LTTE operatives and encouraged Canada and the European Union to proscribe that organization as a terrorist group, which bore fruit in 2006, many Western countries chose to take the LTTE terrorist threat less seriously.

It was against such a backdrop that China came to the assistance of Sri Lanka by providing required military hardware to take conclusive military action against an intransigent LTTE. A bonded warehouse established in Colombo by a government owned company provided vital military hardware required by the armed forces. The author recalls an instance when China allowed a consignment of urgently needed military hardware to be loaded on to a Sri Lankan ship, even without a Letter of Credit from the Sri Lankan side! Thus, China maintained its 'all weather friendship' status to safeguard the vital interests of its ally.

As a sovereign country, Sri Lanka has the right to conduct its foreign relations, carry out trade and encourage investment to meet the needs of the country without succumbing to outside interference. Having gone through a turbulent period due to the armed conflict that sapped its economic vitality for nearly three decades, the political leadership must come up with plans for rapid economic development and satisfy

the needs of the growing population of youth. Failure to do so would be an invitation for return of youth rebellions that the island experienced first in the south and later in the north-east. However, while addressing these crucial issues, successive governments in Colombo must also bear in mind security concerns of its closest neighbor, who sees Sri Lanka as an aircraft carrier parked 14 miles off Indian coast.²⁵ Consequently, political leadership in Sri Lanka must engage in a difficult balancing act and be transparent in the conduct of its policies, so as not to allow its territorial integrity to be destabilized by foreign forces.

Meanwhile China, which has long term interests in the Indian Ocean should take cognizance of the actual ground situation and should restrain itself while carrying out its business in Sri Lanka, whether in pursuit of One Road, One Belt policy, which has received full support of Sri Lanka, as well as making attempts to enlarge its foot print by undertaking massive development projects such as the Colombo Port City-renamed Colombo-Financial City-, taking over of the Chinese built Hambantota Port, Mattala Airport and requesting for 15,000 acres for an industrial estate to be built, managed and operated by the Chinese.

6. The Way Forward

China and Sri Lanka will be celebrating 60 years of establishing diplomatic relations in February 2017. So far, the road has been ‘all-weather’ with occasional distortions to remind both countries, that the relationship needs careful and constant nurturing. China is surely on its way to be the dominant world economic power within the next decade or so, and is fully aware of the importance of island’s strategic location, particularly in relation to President Xi’s OBOR project. Consequently, relations could move only in one direction. However, both China and

25 Choices- Inside the Making of India’s Foreign Policy’, Shivshankar Menon

Sri Lanka should give due consideration to allay India's concerns based on real or perceived security threats resulting from a 'Colombo-Beijing axis'. One solution is for the Indian private sector to actively take part in the development projects in Sri Lanka thereby becoming stakeholders of the development process of the country. The long neglected Trincomalee deep water harbor, with the nearby massive oil tank farm lying dormant since the World War II, which has the potential to be transformed in to a shipping hub to serve the Bay of Bengal countries, could well be a starting point

CHINA'S POLICY TOWARDS SRI LANKA

*Dr. Li Li**

China attaches great significance to its relations with Sri Lanka. Sharing borders with five of the eight SAARC member states, China regards the Subcontinent as an important part of its neighborhood. Although Sri Lanka does not physically adjoin with China and is geographically farther from China than most of other SAARC members, China construes Sri Lanka as a close neighbor and develops a friendly policy to Sri Lanka under the framework of its neighborhood diplomacy characterized by 'amity, sincerity, mutual benefit and inclusiveness'.

China's Perceptions on Sri Lanka

The following three identities represent China's perceptions on Sri Lanka: a time-tested old friend, a close partner of the Belt and Road initiative, and a strategic cooperative partner. It also reflects the significance of Sri Lanka to China.

A time-tested old friend. Modern ties between China and Sri Lanka can be traced back to the Rubber-Rice Pact signed in December 1952, five years before the two side's established formal diplomatic relations. Appreciating Sri Lanka's bold action to supply natural rubber

**Senior Fellow and Deputy Director of the Institute of South and South-East Asian and Oceanian Studies at the China Institutes of Contemporary International Relations (CICIR). Ph.D. in International Relations (Jawaharlal Nehru University, India), Master and Bachelor's Degrees in International Politics (University of International Relations, China).*

to China at a time when China's requests were denied by others due to Western pressure, China supplied rice to Sri Lanka (suffering from a severe rice shortage) at a price lower than the world market price and bought rubber at a higher price than the international price.²⁶ China and Sri Lanka established diplomatic relations on February 7, 1957. In the past six decades, in spite of the dramatic changes in international, regional and domestic circumstances, the bilateral relations have maintained a healthy and friendly momentum. China is grateful to Sri Lanka for its commitment to the One China policy and firm support on the issues such as Taiwan, anti-‘three evils’ (secessionism, terrorism and extremism), and on human rights. Reciprocally, China has offered long-term assistance to Sri Lanka's economic and social development as well as support for its efforts to safeguard the sovereignty and territorial integrity. This long-term friendship has developed into a solid political foundation of China-Sri Lanka relations.

A close partner of the Belt and Road Initiative. Thanks to the globalized economy of China and its heavy dependence on the Middle East oil, in recent past, Sri Lanka has become more relevant to China's energy security and emerged as a major destination for China's overseas contracted projects, investments as well as Chinese tourists. Sri Lanka's significance has been further strengthened by China's Belt and Road initiative launched in 2013. As “a pearl in the Indian Ocean”, Sri Lanka enjoys geographical advantages, connecting both the Asian and the African continents and reaching the South Asian subcontinent. It is against this backdrop that Sri Lanka used to be an important pivot on the ancient Maritime Silk Road.

As Sri Lanka aims to re-emerge as the center of the Indian Ocean trade, China is convinced that Colombo can become an important

26 “Lanka, China rubber rice pact celebrates 60 years,” Daily News, 18 December 2012, <http://archives.dailynews.lk/2012/12/18/bus19.asp>

cooperative partner in building the “21st Century Maritime Silk Road”. In fact, Sri Lanka was the first country to support China’s Belt and Road initiative in the form of a government statement. During Sri Lanka President Maithripala Sirisena’s visit to Beijing in March 2015, he was committed to an active participation in the 21st Century Maritime Silk Road, emphasizing the fact that “the Silk Road is the common historical heritage of Sri Lanka and China”. With the consensus on this issue, the Belt and Road initiative is becoming a reliable powerhouse of the bilateral cooperation on development.

A Strategic Cooperative Partner. China and Sri Lanka agreed to establish a Strategic Cooperation Partnership of Sincere Mutual Assistance and Ever-lasting Friendship in May 2013. This reflected the mutual recognition of the increased significance and affinity of the relationship. Since the China-Sri Lanka relations have been dominated by economic cooperation for decades, a strategic partnership indicates a wish to go beyond the economic area and formulate an all-round cooperation with Sri Lanka. Although China’s Sri Lanka policy will still be economic-oriented and economic-centric in the foreseeable future, China expects to strengthen cooperation and coordination with Sri Lanka in areas as follows: first, the two sides should continue to provide mutual support on issues related to each other’s core interests and major concerns; second, they should continue to support each other on international and regional affairs and reinforce communication and coordination within multilateral frameworks including the United Nations, the South Asian Association of Regional Cooperation (SAARC), the ASEAN Regional Forum (ARF), and the Asian Infrastructure Investment Bank (AIIB); third, they should explore security cooperation including maritime security, anti-piracy, counter-terrorism, disaster management, humanitarian assistance, and military-to-military exchanges; fourth, they should make joint efforts to intensify the people-to-people contacts, respectively formulating a more favorable domestic environment for their mutual trust and strategic cooperation.

The Principles of China's Sri Lanka Policy

Successive governments in Colombo have spoken highly on China's policy toward Sri Lanka. They have repeatedly expressed thanks and appreciation to the Chinese government and people for offering assistance to Sri Lanka's development as well as support in the international arena. The following three pillars or principles have contributed to the success of this policy:

Mutual Beneficial and Win-Win. As a country much larger than Sri Lanka in terms of size and comprehensive power, China treats Sri Lanka as an equal partner, emphasizing that the bilateral cooperation should be based on principles of equality, mutual benefit, and win-win results. Although Sri Lanka has a trade deficit with China, the significant upsurge of Chinese investment in Sri Lanka in recent years has far balanced the bilateral economic ties. Currently, almost one fourth of total FDI inflows to Sri Lanka is from China. China has also replaced Japan as Sri Lanka's largest overseas donor. Between 2005 and 2012, China extended USD 4.67 billion in assistance to Sri Lanka.²⁷ As tourism is a key industry in Sri Lanka and a driving force of its economic growth, the Chinese government is committed to encouraging more Chinese tourists to visit Sri Lanka for sightseeing and shopping. In the first eight months of 2016, nearly 200,000 Chinese tourists have arrived in Sri Lanka. China has become the largest tourist source market of Sri Lanka.²⁸

As far as the Belt and Road initiative is concerned, the Chinese Government has repeatedly emphasized its alignment with Sri Lanka's development strategy and national aspirations. China views Sri Lanka

27 "Port and Power in the Indian Ocean," Asia Maritime Transparency Initiative, <https://amti.csis.org/indian-ocean/>.

28 "China continues to be largest tourist source market of Sri Lanka," Xinhua, September 7, 2016, http://news.xinhuanet.com/english/2016-09/07/c_135669265.html

as an equal partner in jointly building the “21st Century Maritime Silk Road”. The Chinese Foreign Minister Wang Yi made it very clear during his visit to Colombo in July 2016: “Through the joint construction of the Maritime Silk Road, China is willing to help Sri Lanka to realize its national development vision and become the future shipping, logistics and even the financial center in the Indian Ocean so that this pearl in the Indian Ocean can glow with new radiance in this era.”

Above all, China is always ready to provide assistance within its capacity in times of Sri Lanka’s need. For example, in early May 2009, China gave 1 million U.S. dollars in humanitarian aid to Sri Lanka to help the displaced civilians due to the internal conflict.²⁹ After the 2004 Tsunami, China not only offered emergency relief but also made extensive efforts to aid the reconstruction process. When Sri Lanka was hit by floods and landslide in May 2016, China was again quick to provide humanitarian relief, both in cash and kind.

Non-interference. Non-interference into other countries’ internal affairs is a guiding principle of China’s foreign policy. On one hand, it opposes others interfering into China’s internal affairs; on the other, it restrains China from getting involved in others’ domestic politics. China has observed the principle of non-interference in its relations with Sri Lanka for decades. It remains committed to having good relations with all the political parties in Sri Lanka. China is always ready to work with any legitimate Government of Sri Lanka and convinced that the bilateral cooperation should not be affected by Government changes. In spite of some problems that emerged in China-Sri Lanka relations due to Government transition in Sri Lanka in 2015, China has extended its firm support to the national unity government jointly formed by the Sri Lanka Freedom Party (SLFP) and United National Party (UNP). Thanks

29 “China Calls for Stability, Progress in Sri Lanka,” Xinhua, May 19, 2009, http://news.xinhuanet.com/english/2009-05/19/content_11402204.html.

to the joint efforts by both countries, the problems have since been solved and China-Sri Lanka relations have returned to the track of stable development and sound cooperation.

China highly respects the national sovereignty, independence and territorial integrity of Sri Lanka. China has never attached any political preconditions to its aid and investments in Sri Lanka. This is a major reason of Sri Lanka's preference of investments or loans from China over that from the West. In recent years, China has consistently backed Sri Lanka at the U.N. Human Rights Council (UNHRC) where it faces a resolution calling for international probe into alleged war crimes during its 26-year-long conflict. According to a statement of the Chinese Foreign Ministry, China made it clear that it was against any country putting pressure on others in the name of rights violations and that Sri Lanka and its people were capable of dealing with their own affairs.³⁰ When President Xi Jinping paid a state visit to Sri Lanka in September 2014 Sri Lanka's state-run Daily News published his letter to the Sri Lankan people. In the letter, President Xi said: "China firmly supports Sri Lanka in choosing a development path suited to its national conditions, firmly supports the efforts of Sri Lanka to safeguard its national independence, state sovereignty and territorial integrity and resolutely opposes any move by any country to interfere in Sri Lanka's internal affairs under any excuse."

Inclusiveness. China's Sri Lanka policy is people-oriented, which means the bilateral cooperation must benefit the two peoples. With long-term and close government-to-government interactions, China is paying more attention to people-to-people contacts. Although major infrastructure projects (such as ports, highways, railways and airports) constructed by

30 "War Crimes Investigation: China, Pakistan Back Sri Lanka in UNHRC; India Votes Against," 22 March 2012, <http://www.ibtimes.com/war-crimes-investigation-china-pakistan-back-sri-lanka-unhrc-india-votes-against-428664>

the Chinese companies will definitely contribute to national economy and people's livelihood of Sri Lanka, China is becoming aware of the significance and tangibility of smaller projects which are more directly linked to people's daily life. It is against this backdrop that China has committed to more assistance to sectors involving public health (such as the construction of hospitals for kidney disease treatment), education, water conservancy and capacity building.

China's cooperation with Sri Lanka is neither exclusive nor third-party targeted. India is highly alert to the strategic implications of China's growing economic presence in South Asia. Some strategic elites in India construe China's closer links with Sri Lanka as well as other smaller countries as China's encirclement of India, just as what the labeled "String of Pearls strategy" indicates. They have overlooked the fact that the Subcontinent is a part of China's neighborhood. In this context, how to deal with the Indian factor is a key to a sustainable and fruitful China-Sri Lanka strategic partnership. To overcome the dilemma, the Chinese government has proposed a trilateral cooperation among China, Sri Lanka and India. On 27 February 2015, the Chinese Foreign Minister Wang Yi said: "Both Sri Lanka and India are China's important and friendly neighbors in South Asia and important cooperative partners in China's neighborhood diplomacy. China hopes for a sound development of both the China-Sri Lanka and China-India relations, and is pleased to see a continuous development of the Sri Lanka-India relations. A trilateral relationship featuring sound interaction, mutual promotion, mutual benefits and win-win results best fits the interests of the three sides and conduces to regional peace, stability and common prosperity."³¹ He also identified Buddhist-oriented tourism as a potential area for an initial trilateral cooperation.

31 Wang Yi: "China Stands Ready to Actively Discuss China-Sri Lanka-India Trilateral Cooperation," 27 February 2015, http://www.fmprc.gov.cn/mfa_eng/wjb_663304/zjzg_663340/yzs_663350/gjlb_663354/2782_663558/2784_663562/t1241671.shtml

Conclusion

China's Belt and Road initiative not only increases the significance of Sri Lanka to China, but also provides a great chance for Sri Lanka to realize its vision to be a multi-role economic hub in the Indian Ocean. It is against this backdrop that the two countries announced to "work for an all-weather friendship" in April 2016. China has been observing a friendly and cooperative policy to Sri Lanka, characterized in equality, non-interference, inclusiveness and mutual-benefit. It has been welcome by the successive governments in Sri Lanka. However, China's policy is still faced with some challenges as follows: how to better reflect the ground reality of the growing economic inter-dependence; how to meet the people's aspirations on both sides; and how to alleviate India's apprehensions and persuade India to join the efforts for trilateral cooperation with Sri Lanka. The better the challenges are overcome, the greater potential of China-Sri Lanka cooperation will be released.

SRI LANKA CHINA ECONOMIC COOPERATION

*Dr. P. B. Jayasundera**

Introduction

Independent Ceylon, virtually from its very inception extended its sovereign support towards building relations with the People's Republic of China. Demonstrating such strong sentiments, then Ceylon (known as Sri Lanka since it became a Republic in 1972) was among the first few non-communist countries that recognized the Chinese People's Republic of China (PRC) in January 1950. By the end of 1952, the two countries entered into a historic trade agreement in terms of which Sri Lanka agreed to sell a specific quantity of rubber in return for supplies of Chinese rice, over a five year period. This bond was further strengthened through the establishment of Diplomatic relations in 1957. Since then, the bilateral relations and cooperation have continued to deepen and widen, with China emerging as a leading economic development partner of Sri Lanka in recent years. This deep-rooted relationship underscores the changing dynamics of the "look West" policy for trade, investment, finance and tourism once followed by Sri Lanka, to a policy of "look East as well".

**Former Secretary to the Treasury and Secretary, Ministry of Finance & Planning & Secretary, Ministry of Economic Development and Chairman, Public Enterprises Reforms Commission. M.A in Political Economy - 1982 and PhD. in Economics from the Boston University, USA – 1984. Masters Degree in Development Economics from Williams College, USA -1980. B.A. (Hons.) - Economics (1973) & B. Phil. - Economics (1974) from the University of Colombo, Sri Lanka.*

This has to be seen in the context of related global economic activities particularly in Asia, which have placed Sri Lanka at a ‘center point’ attracted by its strategic location. Sri Lanka has also attracted Chinese strategic interest through “One Belt One Route” (OBOR) - China’s new global connectivity initiative while Sri Lanka on its part has turned to China for trade, investments and finance for its development bringing the two countries towards greater global economic cooperation.

This paper will outline certain related milestones between 1952-2016 and reflect on some prospects towards greater development cooperation in the future.

Early Phase of Economic Cooperation

Economic cooperation between the two countries commenced in 1952, four years after Ceylon gained independence from the British Rule, when Sir John Kotelawala was the Prime Minister of Ceylon and Mr. Zhou Enlai was the Prime Minister of the People’s Republic of China. The ‘two commodity’ bilateral trade agreement, more popularly known as the “Rubber Rice Pact,” was signed in 1952. That was five years before formal diplomatic relations were established between the two countries in 1957. This bilateral pact brought about several positive benefits to both countries, by strengthening economic cooperation in all spheres of development in the following years. The Sri Lankan offer for the supply of natural rubber to China was viewed as a strong goodwill gesture since the overture was made in an era when all other rubber producing countries declined to trade with ‘Communist China’ owing to Western pressures. This helped China to secure the flow of an important raw material to support its manufacturing activities.

Sri Lanka at the time was confronted with having to address three critical economic priorities of ensuring food security, stabilizing rubber

producer price and improving the Balance of Payments. Food security was critical to Sri Lanka at that time as a newly independent democratic nation striving to maintain political stability in the backdrop of a global scarcity of rice and high food prices that prevailed in early 1950s. By gaining market access to China at an agreed price in the wake of the downturn in the world rubber prices, the Government was able to support the rubber industry through remunerative prices to the producers. Sri Lanka was thus able to avert a drain on its external assets consequent to a higher trade deficit emanating from high cost of food imports and low earnings from commodity exports, and address the imbalances that prevailed in the Balance of Payments.

The agreement accommodated 50,000 MT of rubber to China annually in exchange of 270,000 MT of rice to Sri Lanka. This constituted a significant proportion of trade between the two nations as export of rubber to China accounted for around 10 percent of Sri Lanka's exports while import of rice too accounted for around 10 percent of imports at the time. The two Governments facilitated trade by establishing a trade agency in Colombo in 1953 to oversee rubber shipments to China. Alongside such economic cooperation, political and cultural ties were also nurtured following the visit of Premier Zhou Enlai to Sri Lanka in 1957, to participate in the Buddha Jayanthi Celebrations. The Rubber Rice Agreement was renewed in 1958 and was extended to cover coconut and coal as well to widen the scope of business between the two nations.

The diplomatic ties between the two nations were further strengthened in 1963, with the visit of Mrs. Sirimao Bandaranaike the Prime Minister of Sri Lanka to China who was the first Sri Lankan Head of Government to visit the People's Republic of China. This visit further boosted bilateral economic cooperation by enabling the two countries to enter into a maritime agreement which extended Most Favored Nation treatment towards each other, in respect of commercial vessels engaged

in the carriage of cargo and passenger transportation. In addition to strengthening trade and economic collaboration, China endorsed the initiative by the Sri Lankan Prime Minister to declare the “Indian Ocean as a Peace Zone” demonstrating how all nations, large and small could work together and coexist in a global political economy, while respecting each other’s geo-political and economic interests.

During Mrs. Bandaranaike’s first term of office from 1960 to 1965, trade and maritime ties expanded between the two countries, with the Chinese Government providing several grants and loans to meet the development needs of Sri Lanka. It is pertinent to note that in the year 1964, China was generous enough to waive-off the entire interest component of all loans thus far extended to Sri Lanka. The Government of China extended concessional loans for the development of textile factories etc. prior to 1977, when Sri Lanka was a closed economy. The first high profile grant aid project was the funding of Rs. 35 million (approximately USD 6 million) for the construction of the Bandaranaike Memorial International Conference Hall (BMICH) where the 5th Non-Aligned Summit was held in Sri Lanka in August 1976.

Even after Sri Lanka embarking upon a market oriented economic model in 1977, China continued its close relations with Sri Lanka. While President J.R. Jayewardene undertook a state visit to China in 1984, Prime Minister R. Premadasa visited China in 1979. The Chinese Premier Li Peng visited Sri Lanka in 1990 when Mr. Premadasa was the President of Sri Lanka. Several landmark projects were supported through Chinese grant funds, including the construction of the Superior Courts Complex at a cost of Rs. 450 million (USD 15 million) in 1985 during the tenure of President Jayewardene (1977-1987) and the construction of a nine storied wing for the Lady Ridgeway Children’s Hospital in 2000, during President Chandrika Bandaranaike Kumaratunga’s term of office (1994 - 2001).

Recent Development Cooperation

Bilateral economic cooperation between China and Sri Lanka entered into a higher scale with the grant of RMB. 450 million in support of Sri Lanka's development projects in 2001 when Chinese Premier Zhu Rongji visited the country. Discussions between Premier Zhu Rongji and President Kumaratunga centered on strengthening bilateral relations, economic cooperation, trade and investment, civil aviation and tourism. Demonstrating growing ties between the two countries, Premier Wen Jiabao visited Sri Lanka in April 2005 in support of post Tsunami reconstruction and development work in the country. The Premier committed USD 28 million for the reconstruction of six fishery harbours and a fishing town in Panadura, which were destroyed by the 2004 Tsunami. During this visit the Chinese Premier put forward a four-point framework for: promoting the traditional friendship, expanding visits of Government and Parliamentary delegations, exploring new areas for economic and trade corporation including the expansion of partnerships in fields such as agriculture, fisheries and tourism enhancing coordination on regional and international issues to strengthen partnership between the two countries.

During President Kumarathunga's state visit to China in August / September 2005, she reiterated Sri Lanka's commitment to further enhance economic relations by stating "China's own economic performance has been stupendous in the past decades. We would very much like to enhance and deepen our economic relationship." The President recalling how the former Chinese President Jiang Zemin paid close interest to study the Greater Colombo Economic Zone in Sri Lanka. invited the Chinese investors to set up business ventures in Sri Lanka, for which Government support was extended. The key projects for which financial assistance was secured by her Government during visits to China, include the 300 MW Coal Power Project in Puttlam, connected transmission lines, jetty and the Performing Arts Theatre in Colombo.

The Golden Jubilee of diplomatic relations between China and Sri Lanka was celebrated in February 2007 with a state visit by President Mahinda Rajapaksa to China. Consolidating the progress already built by successive leaders of both nations and taking advantage of Chinese Government initiative to expand Chinese funding assistance through China EXIM Bank and other financial institutions to developing countries in Asia and Africa provided a unique opportunity enabling Sri Lanka to mobilize funding from EX-IM Bank and large state-owned construction companies of China, towards accelerating large infrastructure development projects in Sri Lanka initiated under the ten year development framework of President Rajapaksa's Government. In comparison to many other fund recipient countries in Asia and Africa, Sri Lanka's 'project readiness' that synchronized with such expansion of Chinese funding, helped the Government to be able to secure Chinese financing for several construction projects, e.g. the Airport Expressway, Moragahakanda irrigation scheme, Hambantota Port and Airport, Southern Expressway beyond Galle, second and third phases of the Puttalam coal plant and Matara - Kataragama railway line. These Projects by then were already in the Public Investment pipeline but were being delayed since successive Governments were not able to implement them due to lack of long term funding.

The progress achieved in 2007 by ending terrorist occupation in the East and ending the armed conflict in the North by mid-2009, helped the Sri Lankan Government to accelerate island wide infrastructure development supported by multilateral as well as bilateral development agencies. During the 2007 Presidential visit to China, the two Governments were able to sign several agreements relating to trade, investment and infrastructure development in Sri Lanka. During this visit, the Sri Lankan President also addressed trade, investment and tourism seminars at Beijing, Shanghai and Guangzhou. Unlike the rather time consuming project implementation periods common with other

development partners, the more expeditious project implementations by Chinese construction companies also helped rapid phase of development since 2006.

As can be seen from Table I, China emerged as the leading partner in Sri Lanka's economic development in several ways. During the last 10 years, China has become the largest single project financing nation with an annual disbursement, amounting to over USD 400 million since 2012 in every single year. This contrasts sharply with little or no fund disbursements, 10 years ago.

Till 2010, Japan played the role of the single largest bilateral lending partner of Sri Lanka, in the area of public investment infrastructure projects financing. As shown in Table I, the amount of committed funds by China for ongoing projects was USD 2,254.6 million by end 2015, whereas the related amount from Japan stood at USD 1,273.3 million.

In comparison, the committed funds for the ongoing project pipeline from the Asian Development Bank stood at USD 1,453 and from the World Bank stood at USD 728 million.

Chinese project loans during the last 10 year period have been mobilized for building power generation capacity (900 mw coal fired power plant, transmission lines, the jetty and related facilities), irrigation (Moragahakanda Reservoir and hydropower project), Port (Hambantota), Airport (Mattala) and railway infrastructure (Matara - Kataragama line), Expressways (Colombo - Katunayake and Galle - Matara), Highways (Dambulla – Kankasanthurai, section of A 9, Jaffna- Mannar B – 32) and several other highways as well.

Table 1 : Public Investments- Project Financing (USD MN)

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	Commitment
ADB		202.7	173.7	291.3	286.0	343.2	291.0	302.2	280.8	346.1	289.1	1,453.3
WB		166.9	122.4	145.2	201.9	154.3	217.2	172.6	215.8	218.5	155.0	729.9
UN		90.8	36.3	103.9	110.8	53.8	110.9	77.8	34.9	16.7	12.1	-
JICA		302.7	232.2	295.9	310.9	336.5	373.5	399.2	277.1	299.5	175.1	1,273.3
Western ¹		174.4	306.7	278.8	242.5	250.0	198.8	242.3	351.1	213.3	259.4	557.8
India		21.5	14.7	0.5	47.4	27.9	208.3	295.1	297.1	193.1	104.9	326.7
China		11.9	43.1	32.1	14.2	125.7	300.4	475.6	584.2	408.7	407.8	2,254.6
Cap.Market		-	500.0	-	500.0	1,000.0	1,000.0	1,000.0	-	1,500.0	2,150.0	-
Other ²		283.8	63.9	244.0	139.8	123.2	181.1	187.5	146.3	153.3	111.3	697.2
Total		1,254.7	1,493.0	1,391.7	1,853.5	2,414.6	2,881.2	3,152.3	2,187.3	3,349.2	3,664.7	7,867.5

Source: Annual Report 2015 Ministry of Finance.

1. Western countries include UK, Netherlands, Sweden, Spain, France, Austria, Belgium, Germany, Denmark, Australia, USA.
2. South Korea, Kuwait, Hungary, Saudi Arabia, Iran, Pakistan and Russia.

Committed funds from China are also earmarked for the completion of the Outer Circular Expressway to link Katunayake and the Southern Expressways, and to construct the final sections of the Southern Expressway from Matara to Hambantota and to set up selected water supply schemes in the country. Infrastructure projects lined up for funding also included Rathnapura expressway and Northen and Central expressways. The funding for these projects came through 15-20 year credit from EX-IM Bank's own resources as well as through the Chinese Government subsidized credit with 3 -5 year grace period largely denominated in US dollar terms. Apart from the EX-IM Bank, China Development Bank too extended financing to Moragahakanda irrigation and hydro power project.

The infrastructure projects covering power generation plants, the expressway network, port and airports and irrigation and water supply during the last 10 years, were no different to such infrastructure development programs that were funded by Japan particularly from 1980 - 2010 as country's lead development partner, e.g. Colombo Port (Jaya container terminal); telecommunication network; hydropower projects (Samanalaweve and Upper Kotmale); transmission and distribution systems; the first phase of the Southern Expressway (Kurundugahahetekma) jointly with the ADB; and Kadawatha - Kaduwela section of the Outer Circular Expressway); construction of a new terminal at the Bandaranaike International Airport and several other infrastructure facilities in support of agriculture, education and health.

Further, the Chinese entry into development project financing was a decisive and pragmatic move in adding value to the much needed capital formation in Sri Lanka in its quest to become a middle income country in the post-conflict period since 2009, when Sri Lanka's traditional Development Partners were unable to raise their annual resource envelopes in view of resource constraints.

If not for such Chinese funding, the then suspended infrastructure projects e.g. airport expressway, Moragahakanda irrigation scheme the Galle - Matara section of the Southern Expressway would not have been a reality today as donors such as the Republic of Korea, Japan and the ADB who, although committed to these projects, could not accommodate them in their country programs.

Second, China has also emerged as the second largest tourist source country for Sri Lanka with the annual arrival growth rate reaching 32.2 percent in 2016. This has to be seen against an average arrival growth rate (from all countries) of 16 percent, indicating that Sri Lanka is likely to be a Chinese dominated tourist destination by 2018, with arrivals exceeding 500,000 tourists as against a projected tourist arrivals from India of around 490,000.

Last but not least, alongside the funding assistance in support of Public Investment Plan (PIP) of the Government, Chinese Foreign Direct Investment into the country has also developed a significant momentum in recent years. A FDI stake in the Colombo South Port by a Chinese company, for the development of a deep sea port terminal with around USD 500 million invested in the breakwater project is one such flagship private investment from China. This project is also funded through the Asian Development Bank to promote the Colombo port development by way of a Public Private Partnership. Large Chinese investments have also taken place in the hotel and property development sector. Chinese FDI as at end 2015 is estimated at USD 1 billion. During President Rajapaksa's tenure the, two Governments initiated a dialogue towards concluding a Free Trade Agreement between the two countries as part of deeper economic cooperation. Sri Lanka played a proactive role to promote another important initiative of China in 2013 in the setting up of the Asian Infrastructure Development Bank (AIIB). The AIIB is set to address future funding needs of Asia particularly in developing countries and Sri Lanka became one of its founding members.

The bilateral cooperation reached a new height when President Xi Jinping of China paid a state visit to Sri Lanka in September 2014. During the visit the two Governments concluded agreements on the development of the Port city of Colombo and Phase Two of Hambantota through large foreign direct investments from China. A Chinese State Owned Enterprise committed a large FDI in Sri Lanka to develop the Port City in Colombo. The project entailed reclaiming a land area of around 269 hectares at a declared cost of USD 1.5 billion for breakwaters, reclamation, and development of the beach front and land preparation. This venture is considered the largest single FDI in Sri Lanka to date. With the aforesaid committed investments to develop a Port City in Colombo, it is estimated that a further USD 4-5 billion of FDI would be attracted in the coming decade.

Despite some initial concerns over the large Chinese presence in the Sri Lankan economy particularly with the Port city venture, the new Government of 2015 led by President Maithreepala Sirisena and Prime Minister Ranil Wickramasinghe too consolidated relations between the two countries. In fact both leaders undertook visits to China seeking to strengthen economic cooperation with regard to the development agenda already developed by two countries. The visits helped to resolve pending issues connected with ongoing projects and expanding the port city development to promote a global financial center there. Collaboration with China will also continue on the development of Hambantota as a large economic zone capitalizing on the port, airport, expressway and railway infrastructure facilities already built in that area in line with the new government's policy of promoting Sri Lanka as an emerging economic hub in the region.

Table 2 : China - Sri Lanka Economic Cooperation Selected Economic Indicators

	1960	1970	1980	1990	2000	2005	2010	2015
Sri Lanka imports from China (USD Mn.)			51	132	251	780	1240	3,712
Sri Lanka exports to China (USD Mn.)			50	3	5	25	76	308
Tourist arrivals from China (No')	-	-	-	-	-	9,810	11,630	214,783
Loans/grants to Sri Lanka (USD Mn)			7.9	-	18.5	11.9	125.7	407.8
Direct Investments year end (USD Mn)	-	-	-	-	-	-	-	1,000.0
Government Debt year end (USD Mn.)*			24.6	23.8	26.1	35.3	508.9	814.3
GDP of China (USD Bn)	88.7	89.6	302.9	396.6	1,208.9	2,291.4	6,005.4	10,983.0
GDP of Sri Lanka (USD Bn)	1.4	2.3	4.0	8.0	16.6	24.4	56.7	82.3
Per capita income of China (USD)	132.9	110.9	309.8	343.5	951.9	1,755.1	4,478.4	7,989.7
Per capita income of Sri Lanka (USD)	142	184	273	472	869	1,242	2,744	3,924

Source: Compiled from Annual Reports (Various Issues)

Central Bank of Sri Lanka and Ministry of Finance, Sri Lanka.

**/ Exclude loans extended to Ceylon Electricity Board and Sri Lanka Port Authority of an estimated sum of USD1, 700 mn.*

Concluding Reflections

Economic cooperation between the two countries, which commenced in 1952, with a two commodity trade pact (Rice and Rubber) has subsequently deepened and widened. This can be seen through expanded project financing assistance to successive governments; increased interest in large-scale foreign direct investments in ports and transshipment trade, property development and hotels as well as developing economic zones along with Sri Lanka becoming a popular destination for Chinese tourists. A successful early conclusion of the ongoing negotiations on a Free Trade Agreement between Sri Lanka and China within the WTO framework as two market economies would increase our market access to China and reduce the trade deficit of Sri Lanka. This would no doubt bring about further opportunities to enhance development prospects for the two nations.

Furthermore, the current phase of development in the two countries has to be seen in the context of China promoting “One Belt One Route” (OBOR) global connectivity initiative towards creating greater global economic cooperation. Sri Lanka’s geographical location offers the two countries great mutual benefits through greater connectivity among Asia, Africa, Middle East and Europe. The Sri Lanka Government’s support to the initiative by China to establish the AIIB and joining it as a founding member was yet another demonstration of the resolve of the two countries to cooperate on an equal footing to promote common economic interests despite countervailing pressures against such initiatives. This is the same spirit reflected in the 1952 ‘two commodity’ trade agreement between the two countries.

Unlike in 1952, Sri Lanka and China are now two market economies. They no longer operate within a single political or regional bloc and are well integrated with the rest of the world. The recent initiatives such as the Colombo Port city development, AIIB and FTA are opportunities

to mobilize and bring the global economy much closer to Sri Lanka Economic cooperation with China as never before underscored the marked transformation from global economic isolation to more open global economic relations for both countries. The mutual respects and trust sustained and nurtured throughout the long-standing bilateral relations would be the strength for a future in which Sri Lanka can play a central role in the process of global economic progress in which East and West economic integration seems to have already become irreversible.

BILATERAL ECONOMIC TIES BETWEEN CHINA AND SRI LANKA

*Dr. Wang Shida**

Introduction

In the modern era, China started commercial and economic cooperation with Sri Lanka in the early 1950s. For example, Sri Lanka signed trade agreement that traded rubber for rice with China in 1952. It is noteworthy that the two countries did not have diplomatic relations then and China was subjected to economic sanctions by U.S together with its allies at that time. With such a good beginning, one can understand why China and Sri Lanka continued to enjoy generally smooth and prosperous economic cooperation in the past 60 years.

Achievements

Trade. According to Customs Authorities of Sri Lanka, the total overseas trade volume of Sri Lanka stood at 14.4 billion U.S dollars in the first half of 2016, which represents a 3% reduction compared to the

**Assistant Director, Institute of South & Southeast Asian & Oceanian Studies, China Institutes of Contemporary International Relations. PhD in International relations (China Institutes of Contemporary International Relations), MA in Law (China Foreign Affairs University), and Bachelor's degree in Arts (Shandong Normal University) and has Served as a Visiting Fellow at New York University (USA).*

same period of 2015. The export trade volume is 5 billion US dollars a reduction by 4.8%, while the import trade volume is 9.4 billion US dollars an increase by 1.4%. Sri Lanka's main export commodities are knitted garments, non-knitted or non-crochet clothing, tea, rubber and related products. Other major export commodities include ships, aquatic products, mechanical and electrical products and fruit. Major import commodities include fossil fuels, machinery and equipment, transport equipment, mechanical and electrical products, knitted fabrics and crocheted fabrics.

According to the Statistics Bureau of Sri Lanka, Sino - Sri Lanka bilateral trade in goods amounted to 2.05 billion US dollars in the first half of 2016 representing an increase by 3.5%. Sri Lanka's imports from China amounted to 1.96 billion US dollars an increase by 10.8%, accounting for 20.9% of Sri Lanka's total imports, while exports to China amounted to 90.26 million US dollars a decrease by 56.5%, accounting for 1.8% of Sri Lanka's total exports. Sri Lanka's trade deficit with China was 1.87 billion US dollars an increase by 19.9%. Sri Lanka's main exports to China include non-knitted goods, knitted or crochet clothing, coffee and tea, plant fibre and footwear products. Sri Lanka imports from China a wide range of goods, that include mechanical and electrical products, machinery and equipment, knitted products, cotton, iron and steel products. In addition Sri Lanka also imports from China items, such as chemical fibre products, fossil fuel, fertilizer, plastic products, furniture, fresh vegetables, footwear and optical instruments.

Now China is the 11th export destination of Sri Lanka and ranks the largest source of imports. Among the top ten categories of imports, China's electromechanical products, textiles, furniture, footwear and ceramic ware retain the dominant position. China's exports of transport

equipment, chemicals, optical instruments and metal products are facing competition from India, Japan, Europe and the United States as well as other developed countries.

Sri Lanka is rich in natural resources and has geographical advantages. However, the proportion of agriculture in the Sri Lankan GDP is relatively high, and the industrial base is comparatively weak. In the meantime, China made great progress in industrialization and needs to transfer some production capacity to Sri Lanka. Thus China and Sri Lanka have great potential cooperation space. Sri Lanka and China are now working towards signing a Free Trade Agreement (FTA) which will greatly boost trade between the two countries. A joint feasibility study on the FTA stated that it would increase bilateral trade, particularly in certain product sectors of Sri Lankan interest, including but not limited to tea, rubber products, fish and fisheries products, textile and clothing, coconut products, gems and jewellery, fruits and vegetables, machinery and electronics.

Investment and Project Contracting. According to the Commerce Department of the Government of China, China's FDI in Sri Lanka amounted to 75.3 million US dollars in 2014 and the overall Chinese FDI amounted to 470 million US dollars up to the end of 2014. Private enterprises of China invest in various sectors including hotel, tourism, agricultural products, fishing, furniture, textiles, storage and logistics. State-owned enterprises of China invest heavily in infrastructure, such as expressways, ports of Colombo and Hambantota, thus making significant contributions to social and economic development of Sri Lanka. For example, the value of project contracting by Chinese enterprise amounted to 2.8 billion US dollars in 2014 representing an increase by 32.4% compared to the previous year. The overall value of project contracting by Chinese enterprises amounted to 13.96 billion US dollars up to the

end of 2014. Chinese ambassador to Sri Lanka, Mr Yi Xianliang, said in April, 2016 that China is Sri Lanka's largest lender and investor, and is involved in the construction of a large number of infrastructure projects, including ports, airports, bridges, highways, railways and power stations. China invests nearly 10 billion US dollars in Sri Lanka, according to the Ambassador.

Port Construction and Operation. State-owned enterprises of China play a very important role in port construction and operation in Sri Lanka. For example, Colombo Port City is Sri Lanka's largest foreign direct investment project. The City is constructed by the Colombo Port City Project Company which is affiliated with China Communications Construction Company (CCCC). President Xi Jinping visited Sri Lanka in September 2014 and inaugurated the project together with then Sri Lankan President Mr. Rajapaksa. According to the plan, CCCC will invest 1.4 billion US dollars in the first phase of the project and will also attract the secondary development investment of about 13 billion US dollars. The Port City will have facilities such as golf courses, hotels, shopping centers, apartments and marinas. After the change of Government in Sri Lanka in 2015, the Port City construction got disturbed and suspended for more than 1 year. In August 2016, CCCC signed a new contract with government of Sri Lanka on building of Colombo Financial City replacing the original contract signed in 2014 on the building of Port City. According to Sri Lankan officials, the Colombo Financial City is positioned as "Sri Lanka's Hong Kong", with a view to establishing a city with independent financial as well as other institutions to maximize business convenience.

The Hambantota Port is another good example of cooperation between China and Sri Lanka. In 2006, the Government of Sri Lanka decided to build a harbor and airfield in Hambantota as well as an

expressway and a rail link from Hambantota to Colombo. China Harbor Engineering Company (CHEC) officially started construction in January 2008. CHEC showed high efficiency and completed the project in December, 2012. The first phase of the Hambantota development project has two 100,000-ton container terminals, two 100,000-ton oil terminals and two 10,000-tonne barge berths, as well as a 1,000-meter waterway. Later CHEC signed the contract for the second phase of the project with the Government of Sri Lanka in December 2010 and started construction in November 2012. Phase II project is 100% financially supported by the Chinese Government loans and the contract value amounted to 808 million US dollars. Under the framework of the second phase, CHEC have finished five 100,000-tonne terminals plus two 10,000-tonne terminals in only three years which is faster than standard international best practices. The Sri Lanka government has approved CHEC further improving the infrastructure of Hambantota to maximize economic and social benefits, thus laying the groundwork for developing Hambantota into a large-scale industrial park. According to the Commerce Department of China, Sri Lanka Government would like to hire Chinese enterprises to operate the port. CHEC has completed the initial planning and feasibility study of the industrial park with focus on the development of shipping services, processing of seafood, agricultural products and other processing and manufacturing industries. CHEC has reached some agreement of cooperation with domestic logistics companies. The development and construction of the industrial park will lead the overall development of the southern region of Sri Lanka, enabling Sri Lanka to build high value-added products processing centers, international shipping centers and international business centers.

Problems

Continuity of Policy. The change of Sri Lankan government has impacted, sometimes negatively on bilateral economic cooperation. Take Colombo Port City as an example, it is a project based on a formal contract between the Governments of China and Sri Lanka and should be carried out in accordance with the contract. However, in early March 2015, the new Government of Sri Lanka suspended almost all large projects under construction, including the port city due to “lack of relevant examination and approval procedures” as well as “no proper environmental assessment”.

A year later, Sri Lanka side finally gave the green light to port city again and declared that the city met all conditions to restore construction. As a result of suspension, the project was delayed for more than 1 year and caused 140 million US dollars loss to CCCC. It also resulted in a kind of negative impact on the international image of Sri Lanka.

Inability of Repayment. Sri Lanka despite having a prosperous economy that has made it the best performer in South Asia for quite some time, is in kind of a debt spiral. It owes \$4.5 billion in payments in 2016 and \$4 billion next year, which is significant for an economy with an annual budget of \$5.6 billion. Things have gotten more complicated that Sri Lanka received \$1.5 billion from the IMF later in 2016. In October 2016, Enterprises Development Minister Eran Wickramaratne of Sri Lanka mentioned that the per capita government debt, which was LKR 63,000 in 2000, had risen to LKR 4 million in 2015. But government’s revenue, which was 17 percent of GDP in 2005, had come down to 12 percent in 2015. However, Finance Minister Ravi Karunanayake is optimistic about Budget 2017. He is positive that the budget deficit target of 5.4% is achievable, and is confident of the 4.7% target for 2017, and eventually

3.5% in 2020. However, according to local media, the country's debt-to-GDP currently stands around 75% and 95.4% of all government revenue is currently going towards debt repayment. Sri Lanka owes several billion US dollars to China and it announced recently that it was looking to convert a portion of this debt into equity for infrastructure investment by Chinese companies. One needs to wait and see how Sri Lanka works out further arrangements for debt repayment.

Geopolitical Disturbance. As the biggest country in South Asia, India remains cautious about any country's effort to make any deep footprint in South Asia and the Indian Ocean region. From the perspective of some Indian strategic thinkers China's investments in Sri Lanka, especially in the port Colombo and Hambantota Ports will partly change the strategic picture of the region. They describe it as part of the so called "String of Pearls" Strategy which is a concept coined up by a report from the U.S. The main idea is that China, especially the Chinese navy will take full advantage of ports in the Indian Ocean, such as Gwadar in Pakistan, Chittagong in Bangladesh, Kyaukpyu in Myanmar and use these ports to contain India. If someone really believes this hypothesis, then the development of the Colombo Port with the help of Chinese enterprises will eventually threaten the national interest of India and affect India's own geopolitical position especially in the light of Chinese submarines and a warship calling at the port near the project area in 2014. Although the development plan of the Port of Colombo and Hambantota was initially designed by the Government of Sri Lanka and the Chinese Government and enterprises were later invited by Sri Lanka to provide financial and technical support. It appears that India is just unable to overcome the suspicion. Mr. Yi Xianliang, China's Ambassador to Sri Lanka, invited India to participate in the Colombo Financial City project in Sep, 2016. He said, "We welcome any third party to join Sri Lanka and China. We are not opposed to India or any other country.

China already has many business relationships with India.” While India remains hesitant about taking up of the olive branch of China, joining in on the financial city project wouldn’t necessarily be too far outside of their established ambitions in Sri Lanka. It is said that India’s Commerce and Industry Minister Nirmala Sitharaman announced that over the next few years India would be investing upwards of \$2 billion in Sri Lanka and Colombo Financial City is the biggest on-going investment project that Sri Lanka has!

SRI LANKA AND CHINA'S BELT AND ROAD INITIATIVE

*Prof. Rohan Samarajiva**

The Silk Road Initiatives

Silk is the word that is common to the two initiatives known as the Silk Road Economic Belt and the Maritime Silk Road. This is apt because silk was not just a fabric when China's trade with the western regions began. It was both an international currency and a luxury product. It was even an object of moral outrage and protectionist sentiment in faraway Rome. Seneca objected to its diaphanous nature. Pliny the Elder complained that 100 million sesterces flowed out of Rome to pay for silk (Frankopan, 2016: pp. 11, 18).

The initiatives bearing the word silk are imbued with multiple meanings even today. Some see them solely in military-strategic terms. Others see them as being solely driven by trade considerations. The truth is probably in between. States do not engage in strategic actions for their own sake. Trade routes have always had strategic significance.

It appears from reports of trains from China arriving in Herat in Afghanistan and Tehran in Iran that significant progress is being made with the Silk Road Economic Belt. But the focus of this contribution is

**Chair of LIRNEasia, Ph.D., Simon Fraser University, Canada. 1985, M.A. (Communication), Simon Fraser University. 1982, Attorney-at-Law of the Supreme Court of Sri Lanka. 1979.*

on the Maritime Silk Road, which is what is of primary relevance to Sri Lanka.

But it is not that the Economic Belt is irrelevant. In its first incarnation, the Silk Road had both terrestrial and maritime components. The Scholar Monk Faxian (337-422 CE), for whom the Pahiyangala Cave in the Kalutara District in Western Sri Lanka is named), arrived in India over the land-based Silk Road, visiting many sacred sites in what are now Xinjiang, China, Pakistan, India, Nepal, and Bangladesh in 399-412 CE as described in *A Record of Buddhist Kingdoms, Being an Account by the Chinese Monk Fa-Xian of his Travels in India and Ceylon in Search of the Buddhist Books of Discipline*.

He is said to have arrived in Sri Lanka by ship from Tamralipti (an ancient port city along the Hooghly River in what is now West Bengal). After two years in Sri Lanka, he left for China by sea, including stops in Java. His account indicates regular movement of regular merchant vessels across the seas. This then, was part of the Maritime Silk Road. The Maritime Silk Road was connected to the terrestrial Silk Road at multiple points (Figure 1). Ven. Faxian's travels show us that the Silk Road was not only about connecting China to Europe; and that its users saw the land and sea components as interchangeable.

Figure 1 : The Ancient Silk Road



Source: NASA

The modern Silk Road envisages connections between the Economic Belt and the Maritime Road too. The initial commitment is to an Economic Corridor across Pakistan to connect the port at Gwadar to the Economic Belt. The other logical connections are through Myanmar. The Myanmar port of Kyaukphyu is already connected by oil and gas pipelines to Kunming in China’s Yunnan Province. Plans have been made to build road and rail links along the trace. Other possible routes that would bypass the chokepoints of the Malacca and Lombok-Makassar straits exist though they are farther from realization. If the BCIM [Bangladesh, China, India, and Myanmar] economic corridor were to pick up momentum, India and Bangladesh would also become key links.

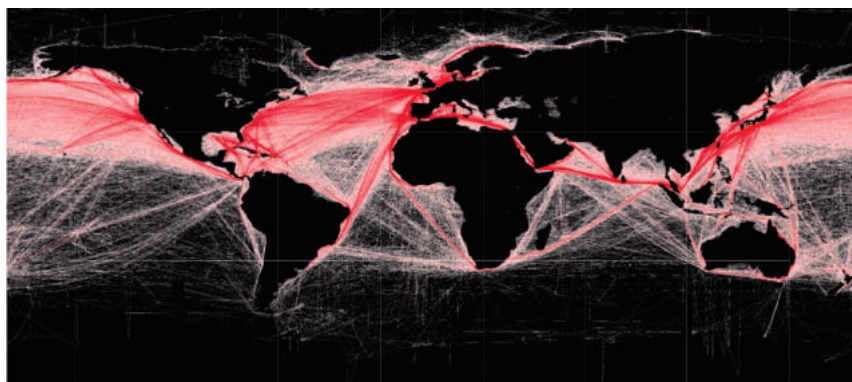
Sri Lanka’s Roles

The island’s role in the infrastructure and trade developments associated with the Silk Road initiatives would be greater or lesser

depending on how much emphasis is placed on the countries around the Bay of Bengal. If the countries, who can influence its developments, including India, give priority to the reawakening of the Bay of Bengal, it will be great. Even if not, Sri Lanka can play a role as a logistics hub for the southern Indian region.

As Figure 2 shows, the southern coast of Sri Lanka lies within close proximity of one of the busiest sea lanes in the world. However, proximity per se is not enough. If it were the Aceh Province of Indonesia would also have got rich. The benefits of proximity can be realized only through a port that ships have reasons to call at. These could include efficient port services and supplies including bunkering. At present, ships have reason to call at Colombo, which has efficient terminal operators and the region's only deep-water harbor. More than 70 percent of the containers that go through Colombo are destined for or are coming from India. This has made Colombo India's second largest port.

Figure 2 : Density of the world's shipping



Source: B.S. Halpern (T. Hengl; D. Groll) / Wikimedia Commons / CC BY-SA 3.0 ma

The Bay of Bengal Reawakens

During the Chola ascendancy (9th to 13th Century), there was much interaction between the Kingdom of Bagan in today's Myanmar and the Lankan Kingdom centered on Polonnaruwa. Beyond their military alliance against the Chola, the kingdoms engaged in economic and cultural exchanges. High-volume, low-value commodities such as rice were traded. Monks traversed the Ayeryawaddy River and the Bay to restore the monk order in Lanka, returning the favor for the flow of Buddhist ideas from Lanka.

During the peak of Chola power the waters now described as the Bay of Bengal were called the Chola Sea. Amrith (2013) states that the term Golfo de Bengala was first used by the Portuguese. Nagapattinam in present-day Tamilnadu was a major port in Chola times. It continued to serve as a key commercial port through Dutch times to when the Bay became a British lake, with many of the littoral states coming under British rule (Amrith, 2013). It served as a departure point for migrants to Singapore, Pinang, Mwalamayne, and Yangon. Visakhapatnam and Coconada were principal ports for people movement to Burma under British rule. Under empire, movement of goods and people were relatively unhindered. Mobility of labor was actively promoted by the British who gave priority to commercial agriculture and resource extraction.

The Second World War and the ensuing wave of decolonization resulted in the decrease of connectivity. The newly independent states were more intent on consolidating national identity. Massive movements of workers and traders from India to littoral states were halted and in some cases reversed. Singapore and Malaysia accommodated the descendants of Indian migrant workers. Sri Lanka took three decades to resolve its problem of "stateless" people; Myanmar is yet to complete the task.

Regional economic integration was a low priority for the newly independent states in the region. Economic issues were excluded in the Final Declaration of the 1955 Asia Africa Conference held in Bandung, finding a place only in the communique. The value of South-South trade promoted even by the structuralist economics associated with Raul Prebisch was not appreciated. The protectionist elements of Prebisch's doctrines crossed the seas from Latin America to Asia, but not the prescriptions for integration of peripheral economies.

As the economies turned inward, connectivity atrophied. The unhappy partition of British India based on the peculiar lines drawn by Sir Cyril Radcliffe in 1947 isolated the North Eastern states of India. The transportation routes developed during the Second World War were closed down. Geography and tensions with the People's Republic of China contributed. But the decisive factor was the withdrawal of Burma from the world economy. As a result, the Bay of Bengal became a backwater of commerce and a laggard in connectivity.

The present weak state of connectivity appears inadequate to support the goal of BIMSTEC [Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation] which is to weave together the fast-growing economies of the region in ways that will result in greater growth and the creation of conditions for more people to emerge from poverty. The region now has a population of over 1.3 billion people (counting only 50 percent of India's population and 25 percent of China's) and a combined GDP of over USD 4 trillion. It is also home to the largest concentration of poor people in the world.

But change is in the air. Myanmar has chosen to end its isolation and is today one of the fastest growing economies in the world. Improved relations between Bangladesh and India since 2008 have been supporting rapid economic growth in the Northern part of the Bay.

In addition to Kyaukphyu in the Rakhine State of Myanmar, Thailand's plans for a port and industrial zone in Dawei in Myanmar's Tanintharyi Region are making progress. This planned new port on the Andaman Sea will be linked to the agglomeration of industry around Bangkok by new, shorter transportation links. India's Cabinet has approved funding for the Kaladan Multi-modal Transit Project centered on a port to be constructed in Sittwe, the capital of Rakhine State. This project envisages cargo moving between Kolkata and Sittwe by ship and then via river and rail between Sittwe and locations in the North Eastern states of India. The objective is to connect the "seven sister" states of India's North East with the rest of the country. It will complement similar transit arrangements being worked out across Bangladesh, restoring historical connections disrupted by partition and subsequent events.

Unlike in the old days, the new connectivity is not limited to ships and land transport. Aviation plays an important role, as does data communication.

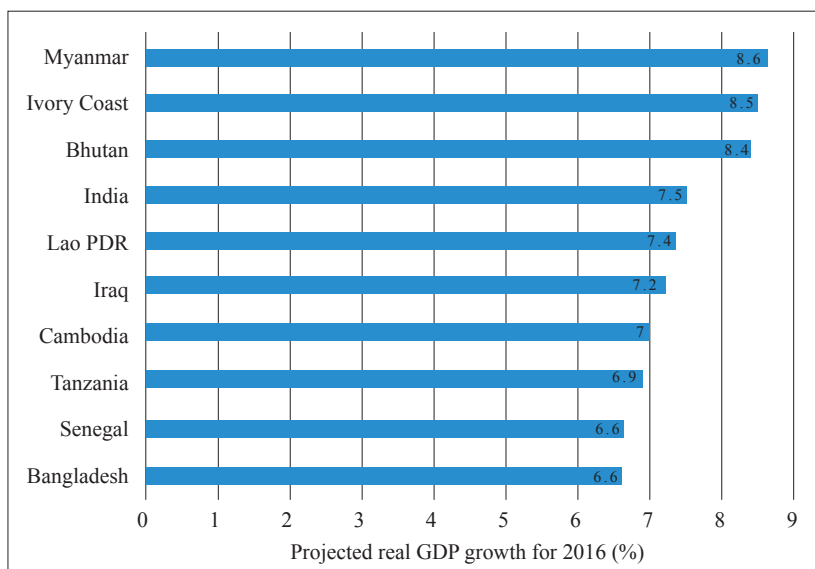
New cables are being laid at a fast pace. Hybrid terrestrial and undersea cables such as the Bay of Bengal Gateway which traverses Malaysia and enters to ocean in Pinang are already operational. The high-capacity undersea cable SEA-ME-WE 5 has already been landed in several locations along its path. The branch cables to Kuakata in Bangladesh and Ngwe Saung in Myanmar are expected to be completed by the end of 2016. Chinese telecom operators own shares in this cable as well as the under-construction AAE 1 cable though they do not actually touch Chinese soil. The terrestrial cables connecting Kunming in the Yunnan Province to the landing point have already been constructed.

Chinese investments in cables exemplify that country's approach to the Bay of Bengal. Given the need to develop the lagging interior provinces and a strong belief in infrastructure as supportive of rapid

economic growth, the Chinese government sees the Bay of Bengal as a critical element of its development efforts. Some have gone so far as to describe Myanmar’s coast as being seen as China’s west coast. Strategic interest in having option to bypass the “Malacca Trap” is a major factor.

As the economies of the littoral states grow, the need for connectivity will be heightened. Greater connectivity will make possible increased economic interactions and thereby further accelerate growth. With four of the littoral states among the 10 fastest growing economies in the world as shown in Figure 2 based on IMF projections. If the adjacent states of Cambodia and Lao PDR are included six of the 10 fastest growing economies are in the region.

Figure 3 : Ten Fastest Growing Economies



Source: *International Monetary Fund World Economic Outlook April 2016.*
<http://www.imf.org/external/pubs/ft/weo/2016/01/pdf/text.pdf>

The considerable investments needed for building the connectivity infrastructure will cause the littoral states to look for assistance. Already China is active in this regard. Geopolitical considerations will drive greater investments by Japan and India, as already evident from Japan's agreement to finance the Matarbari deep sea port in Bangladesh and the financing of the Kaladan project by India, which is actually an Indian domestic infrastructure project running through Myanmar.

If one of two additional factors come into play, connectivity will increase even faster.

The first factor is Myanmar and China reaching agreement on the conditions for the use of Myanmar's territory to permit access to the Bay of Bengal. This will not only assist China, but will also benefit the littoral states through the rapid development of infrastructure serving the Bay.

The second factor is the resolution of political issues in the Bangladesh China India Myanmar (BCIM) economic corridor. At a minimum, this will ease the isolation of the North Eastern states of India. At best, this could result in the linking of the terrestrial Silk Road Belt initiative and the Maritime Silk Road through the Bay of Bengal in addition to the economic corridor terminating in the port of Gwadar in Pakistan.

China is already an important actor in efforts to improve connectivity in the region. In the same way that the non-littoral states of Bhutan and Nepal have been given membership in BIMSTEC, some kind of formal association with China would assist in achieving the common objectives of the member states.

If the Bay does reawaken, Sri Lanka will enjoy the benefits of being its gateway. For example, the now under-utilized Hambantota Port could easily become the interconnector of the shipping lanes running north to the Bay and south through the Malacca strait. Free zones in Hambantota and Trincomalee could become important links in regional value chains.

But it is possible that this optimistic scenario may not be realized. The slumbering Bay may refuse to awaken. The below described shipping and aviation developments can work within the optimal scenarios. Or they can take place even if the optimal outcome is not realized.

Logistics Hub for the Southern Indian Region

Shipping

Colombo is at present India's second largest port, with more than 70 percent of its volume being Indian transshipment traffic. With the opening of the region's only deep-water facility in 2013, Colombo further solidified its position as a maritime hub. Yet, there is little recognition of the role played by the Colombo Port in official Indian transport system policy. Now, it is seen as another foreign transshipment port benefitting from the inefficiencies of India's ports.

Indeed, the Indian government, through its Sagarmala initiative, is building six new major ports, including Colachel at the southern tip of Tamilnadu state and Vizhinjam, a short distance north in the state of Kerala, in what appears to be an effort to reduce reliance on Colombo. But the continued growth of Colombo, despite the building of Hambantota and improvements in performance of the port of Cochin, shows that efficient hub ports cannot be easily displaced. Port services are not a zero-sum game in the context of rapid growth of the kind being experienced in the southern Indian region.

If the government of Sri Lanka succeeds in precluding anti-competitive actions against Sri Lanka ports through trade agreements or otherwise, Colombo may continue to prosper. If Sri Lanka succeeds in positioning itself as a link between the rapidly growing economy of the southern Indian region and India's concerns regarding Chinese strategic intentions are addressed, there is no reason to Sri Lanka cannot become one of the key logistics hubs for the region. This little island is of little value to the maritime Silk Road unless it continues as an integral part of the logistics system of India. Disregarding India's security concerns is likely to relegate Colombo to a feeder port and end its role as a logistics hub.

Aviation

In the 1950s, Colombo was a regional aviation hub. Due to wrong policies it lost this position and is now a feeder to regional hubs such as Dubai and Singapore. However, its geographical advantage has not disappeared. Many cities in the rapidly growing southern states of India are closer to Colombo than to Mumbai and New Delhi. Major upgrades to airport facilities that are underway, if accompanied by restructuring of airport operations to yield efficiencies, may allow Colombo to compete on price and quality to build on its current position as an incipient secondary passenger aviation hub for the southern Indian region.

The badly planned Mattala Airport in the sparsely populated South Eastern region of the country has failed to attract business. According to the Civil Aviation Authority of Sri Lanka's Annual Report, in 2014 the Mattala Airport "handled a total of 20,474 international passengers and 69 metric tons of air freight. Total aircraft movements in and out of MRJA in 2014 were 2,984. With a view to promoting MRJA the government adopted 'open skies' policies in regard of third, fourth and fifth freedom traffic rights out of MRJA to foreign airlines in addition to offering concessionary landing and parking charges."

According to the International Civil Aviation Organization (ICAO), a specialized agency of the United Nations, the Fifth Freedom is “the right or privilege, in respect of scheduled international air services, granted by one State to another State to put down and to take on, in the territory of the first State, traffic coming from or destined to a third State.”³² This freedom, recognized by international treaty, is highly valued. Given the economics of filling aircraft with paying passengers, the prices offered by fifth-freedom flights tend to be very low.

In 2015, the government completely liberalized Mattala, offering all nine Freedoms of the Air to airlines willing to use it. The most attractive of these is the so-called Seventh Freedom of the Air, defined by the ICAO as “the right or privilege, in respect of scheduled international air services, granted by one State to another State, of transporting traffic between the territory of the granting State and any third State with no requirement to include on such operation any point in the territory of the recipient State, i.e., the service need not connect to or be an extension of any service to/from the home State of the carrier.”³³

The Seventh Freedom would enable an airline, without registering as an airline in Sri Lanka, to haul traffic between Sri Lanka and airports in India and elsewhere without the aircraft having to touch its home country. For this to be attractive to a cash-rich, entrepreneurial airline, some, if not all, of the following conditions would have to be satisfied:

32 <http://www.icao.int/Pages/freedomsAir.aspx>

33 <http://www.icao.int/Pages/freedomsAir.aspx>

1. The non-Sri Lankan airline based in Mattala must be able to put down and take on traffic to Sri Lanka from the respective airports, most importantly those in southern India. Given it is not registered in Sri Lanka; this would require the grant of fifth-freedom rights by India. This must be easier than getting third and fourth freedom rights through the airline's home country.
2. Significant cost savings should be realized by operating from Mattala.
3. Some revenue should be earned by taking on or setting down passengers and/or air cargo from Mattala.

In the short-term, it is unlikely that the first condition will be satisfied. Given the mindset of Indian officialdom, it may be easier to gain third and fourth freedom rights as an airline registered in Sri Lanka than gain fifth-freedom rights as a foreign airline operating out of Mattala. This will, in the final analysis, depend on the wording and interpretation of the bilateral air services agreement, as amended in 2003, and any progress made in trade negotiations with India.

For the most part, air freight services are produced jointly along with air passenger services. There exists a complementarity between tourism and high-value agricultural exports, which depend on rapid transportation, preferably via direct routes, to end markets. This requires air transportation of small volumes in the holds of regularly and frequently scheduled passenger aircraft rather than in cargo aircraft.

Unless tourism focused on the South East develops, volumes of passenger traffic to Mattala are unlikely to increase. Unless the volumes increase, more frequent flight schedules to the markets for high-value agriculture exports cannot be justified. Unless frequencies can be

improved, the requirements of high-value agriculture exports will not be satisfied. Luckily, the Gulf and the other West Asian countries are good markets for high-value agricultural exports. So there is a possibility that this kind of air freight services will succeed in tandem with a West Asia focused passenger strategy of the type discussed above.

But there is another opportunity: an air cargo hub. Here, the Seventh Freedom is critically important. The cargo airline will be registered elsewhere. It will simply use Mattala to serve the region around the Bay of Bengal. The packages will be sorted and reloaded on to long-distance flights to Europe, Japan, etc. from Mattala. Jobs will be created; export earnings will be realized. Mattala might, after all, become a valuable component in Sri Lanka's push to become a regional logistics center.

In Sum

The optimal benefits of the Silk Road initiatives will be realized by Sri Lanka only if certain external conditions such as *modus vivendi* between India and China and a mutually agreed upon and stable arrangement for the use of Myanmar territory to connect Western China to the Bay of Bengal are satisfied. However, even if those conditions are not fully met, Sri Lanka stands to benefit from the Maritime Silk Road as long as it can manage the economic and strategic relationship with India.

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SRI LANKA AND CHINA'S BELT AND ROAD INITIATIVE

*Dr. Hu Shisheng**

The Belt and Road Initiative refers to the Silk Road Economic Belt and the 21st-century Maritime Silk Road which were initiated successively by Chinese President Xi Jinping when visited Central Asia and Southeast Asia in September and October 2013. In March 2015, China published Vision and Actions on Jointly Building Silk Road Economic Belt and 21st-Century Maritime Silk Road, marking the formal introduction of a grand initiative.

B&R Initiative aims to build up hardware connectivity, software interface and people to people contacts, to seek balanced win-win development through wide consultation, joint contribution and shared benefits, especially through matching with each other's developmental agendas and plans. It is an open invitation from China to willing partners to jointly seek common development and prosperity.

Generally, the Silk Road Economic Belt will be constructed roughly along the ancient land based Silk Road, connecting the Belt region with

**Senior Researcher in international politics with South Asia in particular, China Institutes of Contemporary International Relations (CICIR); Director, Institute of South & Southeast Asian and Oceania Studies, CICIR. Ph.D. In International Politics & Relations with a focus in Ethnic and Religious issues from CICIR, MA in Sanskrit and Bali language and literature from Peking University, and Bachelor's degree in Hindi language and literature from Peking University.*

the existing international physical connectivity facilities, to interface with each other's institutions, systems, regimes, standards, criteria etc., to link pivotal cities and build up various industrial parks and economic zones along the Belt. There are several outstanding mega-projects like New Eurasia Continental Bridge, China-Mongolia-Russia Economic corridor, China-Central Asia-West Asia Economic Corridor, Bangladesh-China-India-Myanmar Economic Corridor, China-Pakistan Economic Corridor, China-ASEAN Economic Corridor. As for the 21st-century Maritime Silk Road, its construction involves the modernization of critical or important ports, institutional interfacing among various systems, regimes, standards, criteria etc., building up port city cooperation network, setting up various industries parks or special economic zones or free areas to develop the port economy in its various forms, by utilizing fully the local advantages and resources. The land-based Belt and the sea-based Road will finally meet each other through interactions. For example, the initiated BCIM and CPEC would bridge the Maritime Belt Road and Silk Road Economic Belt in South Asia.

Sri Lanka, located in the middle of the Indian Ocean, is much relevant to the 21st-century Maritime Silk Road initiative (MSR). Although Sri Lanka economy is expected to expand at a robust pace in the coming years, the growth will be below potential, owing to a shortage of skilled labor, poor infrastructure and the Government's inability to attract large amounts of FDI. The Sri Lanka-China MSR cooperation could tackle such problems and challenges faced by the Sri Lankan economy, by jointly tapping the potentials and cooperatively exploiting the resources of this island country.

Firstly, MSR could assist Sri Lanka’s efforts in transforming its unique geographical location into a strategic asset and developmental locomotive for Sri Lanka.

Either the ambitious blueprint of Mahinda Chinthana (initiated vigorously by the former president Mr. Mahinda Rajapaksa during this presidential time, referring to the building up of Sri Lanka into five centres as Maritime Center, Aviation Center, Energy Center, Commercial Center and Knowledge Center), or the sustainable development concept,³⁴ emphasized by the incumbent President Mr. Maithripala Sirisena, could largely be materialized under the Sino-Sri Lanka MSR cooperation.

Taking port economy for an example, if the installed capacity of the two port cities—Colombo and Hambantota, now being modernized by Chinese companies as important projects under the framework of MSR, were to be fully utilized, the overall volume of containers being handled each year will exceed what can be handled by all ports in India put together. India, as a matter of fact, lacks such deep sea ports like Colombo and Hambantota. With the completion of the modernization of these two ports, Sri Lanka will become one of the most important and busiest economic hubs of the Indian Ocean region.

Given the limited size of its domestic market, the success of Sri Lanka’s sustainable development with port economy in particular will depend largely upon closer integration with global markets. In this regard, Sino-Sri Lanka MSR cooperation will facilitate the present Sri Lanka Government’s vision of achieving sustainable development and its efforts in building an international logistic and trade hub. By the way, those countries such as China, Japan, South Korea, India, whose trade and energy supply heavily depend upon the SLOCs across the Indian

34 The major contents include five medium-term targets: generating 1m jobs; enhancing income levels; developing rural economies; widening land ownership among the population; and creating a strong middle class.

Ocean, would benefit greatly from Sri Lanka becoming a regional logistic and trade hub.

Secondly, MSR could assist Sri Lanka in improving its economic structure, trade compositions especially with China, and improving its financial situation.

Although the industrial sector now accounts for a larger share of the total output, Sri Lanka's economy continues to be dominated by services. For example, in 2013, the industry, agriculture and service occupied respectively 31.1%, 10.8% and 58.1% of the GDP of Sri Lanka. However, Sri Lanka service industry's main-stays are the financial services, telecommunications and insurance sectors, which cannot provide substantial job opportunities. Moreover, agriculture remains a key source of employment and income, and the industrialization is still not well developed.

- (1) **The imbalance in the economic structure can be improved.** Agriculture, garment and tourist industry contribute mainly to the economic growth in Sri Lanka. While agriculture can be easily disturbed by climate and whether changes, drought in particular, the development of the garment industry depends on the external demand, and tourism can flourish only if there is adequacy of accommodation facilities.

The Following graph shows that the low prices of global mineral resources after 2013 haven't brought about much impressive results in exports and GDP growth for Sri Lanka. One of the reasons for the stagnant exports is that Sri Lanka lacks competitive Manufacturing and Processing Industries. In this regard, China's over-production capacity in industries, ranging from traditional textiles to solar panel manufacturing, could be shifted to Sri Lanka in the name of MSR cooperation between the two countries.

Table 1 : The Performance of Sri Lanka's Exports and GDP Growth during 2011-2017

Years	2011a	2012a	2013a	2014a	2015a	2016a	2017b
GDP (%)	8.4	9.1	3.4	4.9	4.8	5.0	5.1
Goods Export (USD in millions)	10,559	9,774	10,394	11,130	10,533	10,761	11964

a: Actual; b: Economist Intelligence Unit estimates.

Source: IMF, International Financial Statistics.

The tourism sector provides another example. This industry has long been a key pillar of the Sri Lankan economy, contributing to employment, foreign-exchange earnings and investment. However, the further development of tourism heavily depends on the efficient and modern infrastructure support. In 2015, only 2.1 lakhs among 1.8 million tourists in Sri Lanka were from the Chinese mainland, from where as many as 100 million Chinese citizens have travelled abroad in each of the past three years. With the improvement of tourist facilities, more Chinese tourists will travel in Sri Lanka. The Buddhist culture and tradition, prevailing in Sri Lanka, have much favor and understanding among the ordinary Chinese. There are nearly one billion Buddhist believers, followers or practitioners in China. The MSR initiative could then be a driving force in facilitating Sri Lanka Government's efforts to develop the country as a regional tourism hub, through financing the connectivity with international destinations and infrastructures.

More importantly, through the MSR cooperation network, Sri Lanka could make progress in linking up its manufacturing industry with global value chains based upon China's and Sri Lanka's respective advantages. The Chinese Government and businessmen are ready to relocate some manufacturing capacity, which are losing their competitive edge due to the rapidly rising cost of labour and Land Lease while Sri Lanka has the

advantages of geographical location and relatively less costly labor and land resources.

Another example is the textile industry. The share of garments and textile products exported to the US market by China in 2015 was 39%, (with Vietnam 10%, India 6%, Bangladesh 5%, Pakistan 3% and Cambodia 2%). In comparison, the share of exports by Sri Lanka's textile industry, which has been regarded as one of its major industries, is considered negligible in the US market. In recent years, a number of Chinese textile manufacturing factories have been forced to shift to Vietnam and Bangladesh due to the rapid rise of labor costs and land-lease prices. In the future, Sri Lanka could be a much better location for Chinese textile companies to shift or establish their manufacturing factories, if Sri Lanka has integrated itself into MSR.

(2) **The trade deficit can be reduced.** In terms of external markets in 2015, the US accounted for 26.0% of total export of Sri Lanka, the UK 9.0%, India 7.1%, Germany 4.3% and other countries 43.6%. In terms of the share in the total imports by Sri Lanka in 2015, India accounted for 24.5%, China 20.5%, UK 7.1%, Singapore 5.9% and others 42.0%.³⁵ In fact, this trading picture of Sri Lanka has not changed in the past for more than ten years. However, due to the fact that major export markets for Sri Lanka have been in recession since 2009, Sri Lanka's export performance has been deteriorating, from 34% of GDP in 2000 to 16% in 2012 and further down to 12.7% in 2015(see graph below). And not much improvement can be expected even in 2017.

35 The Economic Intelligence Unit, Source: Sri Lanka, Country Report July 2016, Economist Intelligence Unit Limited 2016, www.eiu.com, p12

Table 2 : Sri Lanka's Exports of Goods during 2011-2017

Years	2011a	2012a	2013a	2014a	2015a	2016a	2017b
Export of goods fob (USD mn)	10,559	9,774	10,394	11,130	10,505	10,123	10,912

a: Actual; b: Economist Intelligence Unit estimates.

Source: IMF, International Financial Statistics.

The sluggish exports plus the falling prices of some major export commodities, like garments, tea, rubber etc., and the depreciation of the Sri Lanka Rupee, have widened trade deficit of Sri Lanka steadily during these years. For example, the trade deficit for Sri Lanka increased from just 2.3 billion USD in 2006 (accounting for 19% of GDP that year) to 8.5 billion USD in 2016 (accounting for 10.4% of GDP).

Table 3 : Sri Lanka's trade volume, deficit and depreciation (2011- 2017)

Years	2011a	2012a	2013a	2014a	2015a	2016a	2017b
Export of goods fob (USD mn)	10,559	9,774	10,394	11,130	10,505	10,123	10,912
import of goods fob (USD mn)	-18,242	-19,190	-18,003	-19,417	-18,935	-18,644	-20,109
Trade unbalance	-7,683	-9,417	-7,609	-8,287	-8,430	-9,256	-9,846
Exchange rate SLRs: US\$ (end-period)	113.90	127.16	130.75	131.05	144.06	149.68	155.92

Trade a: Actual; b: Economist Intelligence Unit estimates.

Source: IMF, International Financial Statistics.

A growing trade deficit has not only exerted downward pressure on the local currency, posing macroeconomic risks, as Sri Lanka is facing a heavy debt burden in foreign denominated currencies, but also enlarged the Government's budget deficit. The budget deficit of 2015 stood at 7.2% of GDP and during 2016-20 it will average 5.5% of GDP. This will in turn put heavy pressure on Government expenditure, probably leading to a cut or delay in many planned infrastructure investments. It is obvious that solid infrastructure is a must for Sri Lanka to develop its value adding industries, manufacturing, and its related services in particular. Only then could the local currency depreciation boost the exports and reduce the trade deficit to some extent. At present, this is not the case as can be seen from the above graph "Sri Lanka's trade volume, deficit and depreciation (2011- 2017)". Furthermore, the persistent trade deficit has restricted the Sri Lanka Government's capacity to enlarge its foreign exchange reserves. In 2015, the reserve was only about 7.36 billion USD, barely enough for five months' import.

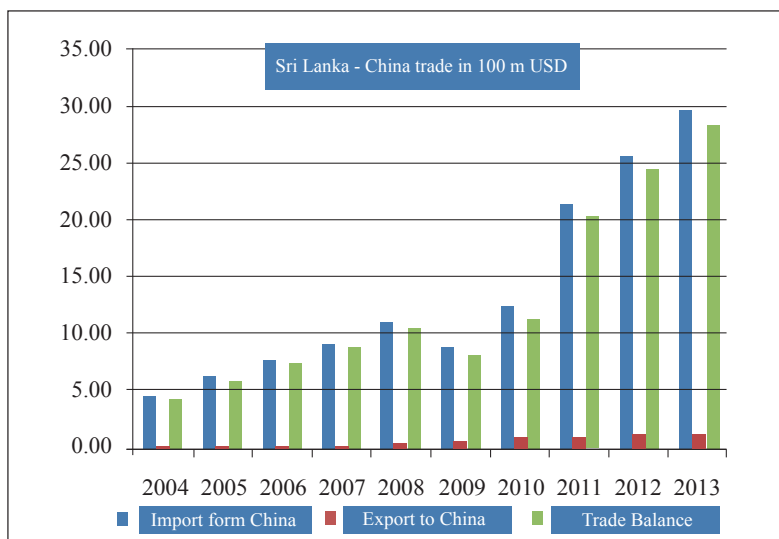
Overall, if Sri Lanka is active in Sino-Sri Lanka MSR cooperation, its trade performance will show impressive progress, due to Sri Lanka's unique geographic location. At a minimum, MSR could assist Sri Lanka's efforts in building on its lead in regional trade and logistic distribution, by making full use of five markets, namely, India, China, the ASEAN, the Middle East and Africa. Sri Lanka can thus become once again the international maritime transportation, trading and logistics distribution hub of the Indian Ocean, and even the base for processing and assembly industries. The current burden of trade deficit could be easily settled.

Moreover, it is important to note that once the much-expected FTA between China and Sri Lanka comes into force, the large trade deficit not only with China³⁶ (see the graph below) but also with other countries

36 According to data released by China's General Administration of Customs, Chinese merchandise goods exports to Sri Lanka in January–November 2015 totalled US\$3.8bn. By contrast, China only imported goods worth around US\$200m from Sri Lanka in the same period.

could be narrowed greatly. It is reported that, under the FTA, Sri Lanka is set to receive preferential access for its exports of apparel, rubber, tea and jewellery products to China. MSR cooperation plus an FTA arrangement with China would help realize Sri Lanka’s ambition of becoming a trading centre within this region and beyond.

Figure 1 : Sri Lanka’s trade volume, deficit and depreciation (2011- 2017)



Source: UN Comtrade Statistics

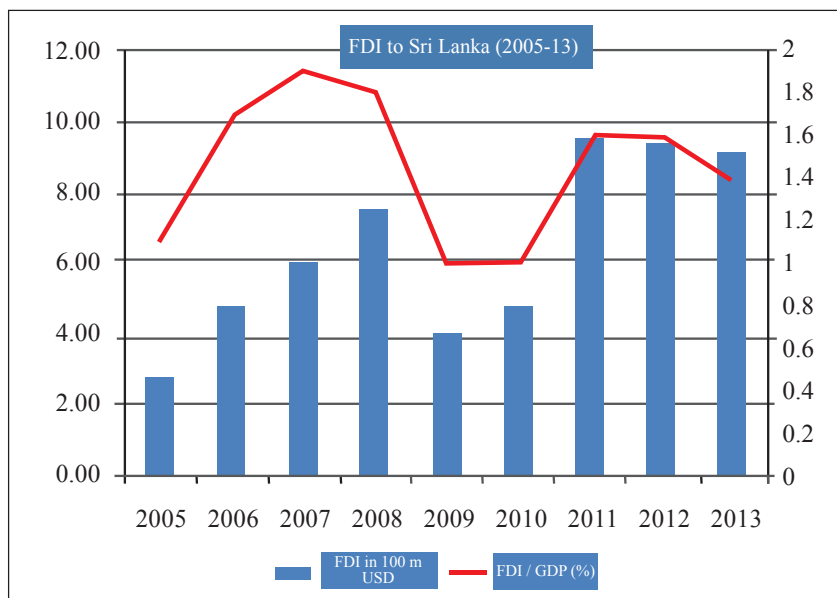
If, facilitated by MSR cooperation, Sri Lanka gradually has a much developed physical and institutional infrastructures; at least some of the imports from China can be produced in Sri Lanka. Data on bilateral trade indicate (see the graph below) clearly that Sri Lanka’s export to China is mainly composed of raw materials, while the majority of the imports from China is composed of ready-made and high value-added items, many of which can be easily manufactured in Sri Lanka.

Table 4 : Bilateral Trade Composition Between Sri Lanka and China (in million USD)

Exports to China in 2014	Apparel (gar- ment)	Footwear	Tea in Bulk	Mixed Coir Fiber	Mattress fiber	Rubber Plates,sheets, rods of Vul- canized or Unhardened Rubber	Pneu- matic & Re- treated Rubber Tyres & Tubes	Mineral Sands	Tea Packets	Coco Peat & Fiber Pith
Share in total exports to China	20.5%	11.2%	10.4%	8.5%	7.3%	4.7%	3.7%	3.6%	3.1%	2.6%
Imports from China in 2010	Woven fabrics	Other Electrical & Elec- tronic Products	Petro- leum Prod- ucts	Tele- phone sets, Audio/ Video Equip- ments & Parts	Other Products of Base Metal nes	Fertilizer	Boat Building	Other Prod- ucts of Plastics	Other Textile Articles nes	Auto- matic Data Pro- cessing Ma- chines
Share in total imports to China	22.4%	11.8%	7.8%	7.5%	7.5%	4.1%	3.5%	2.5%	2.4%	2.3%

- (3) **The FDI flow-in can be encouraged.** Since 2009, Sri Lanka Government has persuaded several favorable policies, such as reducing some non-tariff barriers, streamlining the foreign direct investment regime, gradually privatizing some state-owned enterprises, in order to attract more FDI. However, not much progress has been made (see “FDI to Sri Lanka” below). Even some reforms related to the changes in tax policies (including the value-added tax), strongly suggested by the major international lenders and financiers like the IMF, WB, have raised the eyebrows of some potential investors.

Figure 2 : FDI to Sri Lanka during 2005 to 2013



Moreover, the external debt is becoming more and more challenging. The construction of nearly all the mega-projects in Sri Lanka depends upon external assistance, loans and credits, which have contributed to the startling external debt, counting more than half of GDP (see Table 5).

Table 5 : External Debt of Sri Lanka (USD Mn)

Years	2011a	2012a	2013a	2014a	2015a	2016a	2017b
Nominal GDP (US\$ mn)	65,292.	68,434.	74,317	80,024	82,316	83,640	87,940
External debt (US\$ mn)							
Debt stock	25,887	35,792	40,257	43,609	45,469c	48,085	50,705
Debt service paid	1,302	2,000	2,020	2,490	2,971c	2,924	2,905
Principal repayments	817	1,421	1,366	1,775	1,956c	1,987	1,905
Interest	485	578	654	716	1,015c	936	1,000

a: Actual; b: Economist Intelligence Unit estimates.

Source: IMF, International Financial Statistics.

In this regard, MSR initiative could also play an important role in helping Sri Lanka to address such financial crisis and capital-shortage issues. In line with the purposes of B & R Initiative, the use of local currencies is also one important aspect. During Chinese President Xi Jinping's state visit to Sri Lanka in Sept. 2014, the leaders inked a local currency swap agreement of 10 billion RMB (about 1.6 billion USD). Such swap arrangement granted by Bank of China and investment provided by Silk Road Fund and AIIB-the two financial arms of the Belt and Road Initiative could provide solid support to the infrastructure construction in Sri Lanka, including ports, highways and airports. AIIB has already announced its first investment in June 2016, a co-financing arrangement with ADB and the UK Department for International Development, for a motorway in Pakistan. This model could be replicated in Sri Lanka as well. Another example is that the decision by, the \$40-billion Silk Road Fund to inject capital into China Three Gorges South Asia Investment Ltd to develop the Karot hydropower project on the Jhelum River in northeastern Pakistan.

Thirdly, MSR could assist Sri Lanka Government in the post-conflict reconstruction.

The conflict during the 1983-2009 period had turned Sri Lanka from the “Pearl of the Indian Ocean” into a “Teardrop of the Indian Ocean” it is said. Especially the Northern Province, which is home to 1.5m people, or about 7% of the country’s total population had suffered much from the conflict and has not fully recovered from it yet. Much of the area had been controlled by the Liberation Tigers of Tamil Eelam during the country’s bloody conflict. Nearly three decades of conflict, plus the devastation inflicted by the Indian Ocean Tsunami in 2004, have wreaked havoc on the Northern and Eastern Provinces. Essential infrastructure suffered serious damage and neglect in the two Provinces. Thanks to the support from multilateral lenders such as the World Bank and IMF, investment has begun to flow into the conflict affected areas. However, the transport connections, bridges, sea ports and electricity transmission lines still lag behind compared to other areas of Sri Lanka. Much more investment will be needed over the coming years given the dearth of investment in the past. The Sino-Sri Lanka MSR cooperation could bring about positive changes to this region.

For example, the port city of Trincomalee could greatly benefit from the modernization process supported by MSR’s financial institutions, like the AIIB and the Silk Road Fund. The Trincomalee port, being one of the few natural deep-water harbours in the region, is the country’s second busiest in terms of the volume handled and could bring in further income from cargo handling, ship repairs as well as port-related industries and services. Currently, Sri Lanka Government has identified Trincomalee as a key economic zone that could be developed into an agricultural and energy hub.

Fourthly, MSR could assist the joint harnessing of the human resources for the future.

Since Sri Lanka lacks a solid industrial base, China can provide advice and suggestions in developing the country's industry with emphasis on manufacturing. As done in the Hambantota port city project, apart from trading and transferring cargos, industrial parks can be established, Free Area for export-oriented manufacturing, processing and assembly industries can be established, shipping services and refreshment entertainments for sailors can also be developed. In all these areas, China has its unparalleled competitive edge. All these arrangements can be incorporated in the Sino-Sri Lanka MSR cooperation framework. In view of Sri Lanka's relatively small population it is not recommended to shift the low-value addition and labour-intensive Chinese industries to Sri Lanka. However since Sri Lanka has at least 1 million citizens earning their livelihood abroad, such labour forces with rich overseas working experience could be the strategic human resources for Sri Lanka to start up new industries, in order to fully exploit the potential of its port-related economy.

In preparation of this promising development prospect, it is imperative for China and Sri Lanka to jointly undertake professional training and vocational education. At present Sri Lanka has about 400 skills or professional training schools or centres, and 15 universities at the national and provincial levels. Chinese training schools and universities with commercial, financial and business administration faculties in particular, could carry forward cooperation with their Sri Lanka counterparts in this regard. Such educational cooperation could also be included in the MSR cooperation framework. Counseling and law services and practices could also be one part of such cooperation.

The traditionally good bilateral relations between China and Sri Lanka will provide the political guarantee to further consolidate economic relations under the MSR cooperation.

There could be distractions to promoting Sino-Sri Lanka MSR cooperation, e.g. India's interference in guarding against increasing Chinese presence and influence in Sri Lanka, the internal political differences and 'regime-changes' etc., in Sri Lanka. However, there are several advantages for Sri Lanka to benefit from Sino-Sri Lanka MSR cooperation; Sri Lanka's unique geographic location, its relatively stable political environment, impressively safe and peaceful society in the country since the end of conflict in 2009, mutual affinities and understandings based on cultures and traditions common to these two peoples, the impressive presence of Chinese investments and Chinese constructed mega-projects in Sri Lanka, and most importantly, the consolidated Sino-Sri Lanka relations that withstood the test of time and geo-politics. All these advantages will militate in favour of MSR cooperation achieving success in Sri Lanka.

As a matter of fact, China owed a lot to Sri Lanka. During the cold war period, it was Sri Lanka government who helped China, through the Rubber and Rice Pact, to break the isolation and embargo imposed by the Western countries led by the US.

Over this century, the Sino-Sri Lanka relations have witnessed progress in leaps and bounds. In April 2005, the two governments have established an all-around cooperative partnership with sincere mutual-assistance and everlasting friendship. In May 2013, the bilateral relation was upgraded to a strategic cooperative partnership; and in Sept. 2014, the two Heads of State expressed commitment to build a strategic cooperative partnership facilitating the joint construction of the MSR.

Meanwhile China has replaced the US to be the second largest trading partner of and exporter to Sri Lanka. China has also become one of the major investors in Sri Lanka, recording a 50 fold increase in investments during the past ten years. During the 2013-2014 period alone, China had invested US\$5.2 billion in Sri Lanka, a one third of which went into the road constructions. More importantly, China has replaced Japan to become the largest developmental aid donor to Sri Lanka. During the period 1971-2012, Chinese assistance to Sri Lanka amounted to US\$ 5.056 billion of which US\$4.76 billion was provided by China during 2005-2012. China had promised another US\$2.18 billion (in loans and credits) to Sri Lanka in 2012- 14.

Overall, Sino – Sri Lankan cooperation beckons a much more promising future. It is obvious that such cooperation will herald an era of prosperity not only to the two peoples but also to the region as a whole and even beyond.

BILATERAL ECONOMIC TIES: SRI LANKAN PERSPECTIVE

*Prof. Sirimal Abeyratne**

Introduction

Sri Lanka's economic relations with China began in the very early years after Sri Lanka gained independence from Britain in 1948 and after the establishment of the People's Republic of China in 1949. Sri Lanka, which was then known as "Ceylon" until it became a Republic in 1972, was one of the first few non-communist countries to recognize the People's Republic of China as early as in 1950. The diplomatic relations between the two nations commenced in 1957.

Even if many countries in Asia were non-communist, it was a time when anti-Western and pro-nationalist sentiments were gaining momentum in both political and economic spheres. Most of these countries were gaining political independence and, at the same time, turning to import substitution policies by dwindling their economic ties with the Western capitalist countries. It was also a time that the Cold

**Professor in Economics of the University of Colombo. He has earned his PhD degree from Free University of Amsterdam, MA and MPhil degrees from International Institute of Social Studies, The Hague, and Bachelor's degree from University of Colombo. His teaching and research interests are basically in the field of international trade and development; he has engaged in research work in the areas of regional trade, policy reforms and liberalization, economic dimensions of civil conflicts, development policy issues, and the current economic affairs.*

War was impacting economic policy making and international relations in developing countries. It is in this context that China – Sri Lanka ties were strengthened and modern economic relations between the two nations evolved.

The well-known Rubber – Rice Pact in 1952 was an important early milestone in bilateral economic ties between the two countries. During Sri Lanka's import substitution trade regime from 1956-1977 (Abeyratne and Rodrigo 2006, Athukorala and Jayasuriya 1994, Lakshman 1997), and against the backdrop of Non-Aligned Movement that commenced in 1961 in which Sri Lanka played a major role in the 1970s, Sri Lanka's economic and political relationship with China strengthened. During the post-1977 liberalized trade regime in Sri Lanka (Abeyratne and Rodrigo 2006, Athukorala and Rajapatirana 2000, Lakshman 1997), while there was rapid economic integration with the Western countries and market-oriented economies, the economic relationship with China did not grow. In the recent past, however, Sri Lanka's economic ties with China have reached new heights reflecting the signs of stronger and deeper integration in the future. As it appears at present, Sri Lanka's intensifying economic ties with China, which are to be enhanced further and managed better, could be a strong foundation for the country's development process in the years to come.

The purpose of this study is to outline and analyze key areas of Sri Lanka's bilateral economic ties with China from a Sri Lankan perspective. As the study reveals, the key areas of economic ties are found in trade, investment and finance, and tourism. Given the new initiatives such as bilateral trade agreements, special investment projects, and the Maritime Silk Route, these economic ties are expected to expand exponentially.

Bilateral Trade

Although Sri Lanka's bilateral trade with China has been growing rapidly in the last few years, it appears to be relatively more significant in the past than in the present. Early statistical reports have specifically recorded Sri Lanka's bilateral trade with China, along with its trade with the so-called Sterling Area and Dollar Area (Central Bank of Ceylon 1954). As a natural outcome of the colonial heritage, large part of Sri Lanka's trade in the early years after Independence had been with the Sterling Area. However, as the Central Bank of Ceylon (1954:15) reported, within three years from 1951-1953 trade with China has recorded a massive upsurge: Exports to China increased from 1.9 percent of total to 15.4 percent, and imports from China from 0.3 percent of total to 13.0 percent.

Rubber – Rice Pact 1952

Initial expansion of Sri Lanka's bilateral trade with China since the early 1950s was largely an outcome of the Rubber – Rice Pact between the two countries (Central Bank of Ceylon 1954:11-13). During this period, about half of Sri Lanka's exports comprised of tea, while another quarter comprised of rubber. On import side, rice accounted for about 20 percent of total imports of Sri Lanka as the domestic supply of this staple food grain was limited. In fact, Sri Lanka continued to provide rice ration free of charge to every citizen – a rice ration initiated during World War time against global food shortage, and continued for nearly three and half decades as a key element in Sri Lanka's extensive welfare policy (Abeyratne 2000).



Commemorative Stamp issued by the Government of Sri Lanka in 2002 to mark the 50 years of signing the Rubber - Rice Pact

Source: Sunday Times, 23 December, 2012: "When rice was bartered for rubber between Ceylon and China" by Nihal Mallikaaratchi

China, on the other hand, had the issue of importing rubber, because rubber-producing countries at the time under the influence of Cold War politics were reluctant to export rubber to China. The Rubber – Rice Pact ensured continuous supply of rice for Sri Lanka and rubber for China under agreed prices. Thus, under the Rubber – Rice Pact, rubber and rice were bartered between China and Sri Lanka.

It is interesting to note the distinctive characteristics of the development discourse between the two nations as embodied in the Pact because China purchased rubber for production (as a raw material for industries) and Sri Lanka purchased rice for consumption (distributed free of charge). However, on the part of Sri Lanka, the Pact was helpful to guarantee stable world market prices of rubber – the second highest primary commodity in the country’s export mix, enabling Sri Lanka to address the contemporary food shortage issue in the domestic market, and to contribute to the stabilization of the country’s balance of payments.

The Pact was important for both Sri Lanka and China and was effective for nearly three decades until it was considered non-effective in the early 1980s. Sri Lanka has become almost self-sufficient in rice by the early 1980s, while it had already discontinued its rice ration system

in 1978. At the same time, China which had initiated policy reforms for liberalization was also able to purchase natural rubber in the world market without international restrictions. Although the Pact became non-effective, the national sentiments attached to it from both sides continued to be important in conditioning the subsequent economic ties between the two countries.

Table 1 : Sri Lanka’s Bilateral Trade with China, selected years 1980-2015

	Exports		Imports	
	USD million	% of total	USD million	% of total
1980	47.1	4.8	46.7	2.5
1985	16.9	1.3	70.1	3.6
1990	4.3	0.2	120.7	4.6
1995	3.3	0.1	152.2	3.4
2000	4.8	0.1	237.7	4.0
2005	29.4	0.5	630.6	7.2
2010	72.0	0.8	1240.0	9.2
2015	308.0	2.9	3712.0	19.6

Source: Central Bank of Sri Lanka, Annual Reports

Table 2 : Sri Lanka’s Major Trading Partners 2015

Top 10 export destination markets			Top 10 import source markets		
	Exports (USD mn)	% of total		Imports (USD mn)	% of total
USA	2,810	26.7	India	4,268	22.5
UK	1,029	9.8	China	3,712	19.6
India	643	6.1	Japan	1,389	7.3
Germany	476	4.5	UAE	1,067	5.6
Italy	434	4.1	Singapore	1,063	5.6
China	308	2.9	Malaysia	508	2.7
Belgium	283	2.7	Thailand	497	2.6
UAE	276	2.6	USA	471	2.5
Netherlands	220	2.1	Taiwan	460	2.4
Japan	216	2.1	Indonesia	459	2.4

Source: Central Bank of Sri Lanka, Annual Report 2015

Trade with China after Liberalization

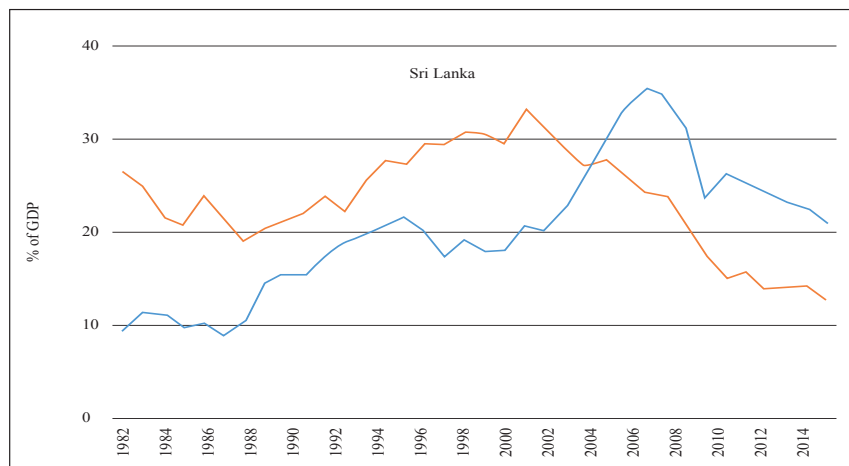
Sri Lanka's policy reforms for trade liberalization in 1977 along with China's policy reform process made significant alterations in bilateral trade between the two countries. In fact, China too began its policy reform process in 1978, which was distinctively different from the Sri Lankan policy reforms. Sri Lanka adopted an 'overnight' drastic change in its trade strategy shifting from one of the most stringent interventionist and import substitution regimes to a liberalized export-oriented regime. China followed a cautious and gradual reform process towards an open economy.

Until the early 2000s, Sri Lanka's exports to China declined in absolute terms, and then marked a significant and gradual increase thereafter (Table 1). Sri Lanka's imports recorded a slow pace of increase first, and then after the mid-2000s, a sharp escalation. Accordingly, Sri Lanka which had a bilateral trade surplus with China in 1980 experienced a growing trade deficit during the subsequent years. As of 2015, Sri Lanka's imports from China which amounted to USD 3.7 billion were more than 10 times larger than Sri Lanka's exports to China.

Trade expansion in Sri Lanka and its structural changes were largely in line with the market requirements of Western Europe and USA which together provided destination market for more than half of Sri Lanka's exports. Among the top 10 export markets of Sri Lanka, however, China is also ranked as the 6th largest, and India, the 3rd largest (Table 2). On the import side, however, Sri Lanka has turned from the Western markets towards Asia; while India has become the largest import source market for Sri Lanka supplying 22.5 percent of total imports as of 2015, China occupies the position of the 2nd largest source market supplying 19.6 percent. The Free Trade Agreement between Sri Lanka and India that was effective since 2000 as well as India's own policy reforms initiated since 1990 were major factors underlying the rapid trade expansion

between the two countries. Even without a bilateral trade agreement as such, yet China has elevated to be an important trading partner of Sri Lanka in the recent past.

Figure 1 : Merchandise Exports of China and Sri Lanka as % of GDP 1980-2015



Source : World Bank, World Development Indicators

Sri Lanka’s weak penetration into export markets in China owes much to the country’s own weak export performance. It is true that Sri Lanka’s exports expanded and the structure of the export mix changed after the policy reforms. But this should be considered in a relative sense, because much of the changes that took place in the 1980s-1990s have slowed down subsequently. Merchandise exports of Sri Lanka reached its peak point of expansion by 2000 recording 33 percent of GDP; then it declined gradually in the subsequent period of 15 years recording just 12.7 percent in 2015 (Figure 1). In contrast, merchandise exports of China grew from around 10 of GDP in the mid-1980s to over 35 percent of GDP in 2006; then its slow down started and reached just over 20 percent of GDP in 2015.

Table 3 : Sri Lanka's Major Export Products to China 2015

	USD Mn.	% of total
Boat Building	118.6	40.1
Apparel	53.7	18.1
Tea in Bulk	27.0	9.1
Footwear	20.9	7.0
Mineral Sands	9.9	3.3
Mixed Coir Fiber	8.7	3.0
Mattress Fiber	6.4	2.2
Tea Packets	6.3	2.1
Other Electrical & Electronic Products	4.6	1.5
Pneumatic & Retreated Rubber Tyres & Tubes	4.2	1.4
Activated Carbon	4.2	1.4
Coco Peat & Fiber Pith	3.2	1.1
Petroleum Products	2.5	0.8
Bristle Fiber	2.1	0.7
Total exports	295.8	100.0

Source: Export Development Board of Sri Lanka

Table 4 : Sri Lanka's Major Imports from China 2015

	USD Mn.	% of total
Woven Fabrics	744.1	20.0
Products of Base Metal	440.9	11.8
Electrical & Electronic Products	432.0	11.6
Telephone Sets, Audio/Video Equipment & Parts	322.3	8.7
Fertilizer	191.6	5.1
Petroleum Products	100.3	2.7
Automatic Data Processing Machines	96.6	2.6
Motor Vehicles & Parts	96.0	2.6
Products of Plastics	89.6	2.4
Textile Articles	84.5	2.3
Processed Food	81.1	2.2
Paper Products	63.6	1.7
Inorganic Chemicals	56.6	1.5
Transport Equipment	54.7	1.5
Apparel	53.4	1.4
Total imports	3725.4	100.0

Source: Export Development Board of Sri Lanka

The differences in export performance between Sri Lanka and China require a further elucidation in order to avoid misleading comparisons. The slowdown in export performance carries more serious economic implications in a small economy like Sri Lanka where economic growth is linked directly to export performance. Growth that does not emanate from the tradable sector and not directed towards international market, is unsustainable.

Exports to and Imports from China

According to the statistics of the Export Development Board of Sri Lanka, over 40 percent of total exports from Sri Lanka to China appear to have emanated from a single source – boat building (Table 3). This also seems to be a new export item of which exports to China appear to have expanded during the past 3 years. Apart from that, apparel, tea in bulk, and footwear are among the most important exports of Sri Lanka. A notable characteristic of Sri Lanka's exports to China is that the export mix comprises of a large share of traditional raw materials such as tea in bulk, mineral sands, fiber varieties and carbon. The country is only at the early stages of exporting finished products such as apparel, footwear, tea packets, electrical and electronic products as well as parts and components for assembly activities in China.

The largest import item is woven fabric which accounts for 20 percent of Sri Lanka's imports from China in 2015 (Table 4). Apart from that, Sri Lanka also imports raw materials such as fertilizer and chemicals. However, the import mix consists mainly of the finished manufactured products such as base metal items, telephone sets, audio/video equipment, data processing machines, motor vehicles, plastic products, processed food, apparel, and transport equipment as well as parts and components of some of these import products. The comparison clearly shows that imports from China consist of much more sophisticated manufactured

products, and parts and components of thereof than those limited number of exports from Sri Lanka.

Free Trade Agreement under Negotiations

Negotiations were initiated in November 2014 between China and Sri Lanka in order to enter into a bilateral free trade agreement (FTA). Sri Lanka has already entered into two bilateral free trade agreements, one with India commenced in 2000, and the other with Pakistan commenced in 2005. Followed by these FTAs, Sri Lanka's trade with both India and Pakistan has increased, but posed more questions than answers (Abeyratne 2012). Since the end of the Rubber – Rice Pact, Sri Lanka and China did not have a bilateral trade agreement. They both are members of one of the oldest multilateral trade agreement - Asia-Pacific Trade Agreement (APTA), initially known as the Bangkok Agreement (1976). While Sri Lanka was a founding member of APTA, China joined it in 2001. Other member countries of APTA are Bangladesh, India, Laos, and South Korea.

One important point of reference is that, on the part of Sri Lanka, the proposed China – Sri Lanka FTA was a result of a request from the country's business community. From the Sri Lankan point of view, the proposed FTA with China would offer free access to the biggest export market in the world with over 1.3 billion population. In addition, it is also expected to boost investment in Sri Lanka which would expect to penetrate into the Chinese export market. From the Chinese point of view, Sri Lanka offers an important geographic location with established open economic policy regime and efficient trading posts along its Maritime Silk Road. As we discuss later, China has already started investing in Sri Lanka surpassing all other countries.

In order to realize the anticipated free trade benefits of the proposed China – Sri Lanka FTA, there are however, a number of issues that need to be addressed. Even though China offers free access to its large market, the issue is that whether Sri Lanka has the capacity to increase exports supply and benefit from the big market. The importance of this issue is already evident in Sri Lanka’s dismal export performance over the past one and half decades. The problems appear to be more internal than those related to market access. Secondly, Sri Lanka’s need to retain a rather long sensitive list (amounting to 40 percent of tariff lines of 2016) appears to limit the benefit of free trade absurdly. Thirdly, it is absolutely necessary to understand the implications of the particular trade pattern of China, dominated network trade (Athukorala 2011, Kimura 2006, WTO 2011); as a result, ‘rules of origin’ regulations in a FTA may oust a large part of trade creation due to lower domestic value addition in exports under network trade. Finally, Sri Lanka has to pay more attention the implementation its own policy reform process and strengthen its investment-friendly policy environment in order for the country to reap the benefits of free trade with China.

Investment from China

Investment funding from China is two-fold: First is the foreign direct investment (FDI) which does not have a local component as a commitment. The second is the project loans for public investment which carry components of local commitment. Part of the commitment is to provide local counterpart funding from the government budget to supplement usually a smaller part of the public investment. In addition, Sri Lanka should pay back the project loans with interest.

According to ‘Build-Own-Operate’ (BOO) arrangements in Sri Lanka, China as the investor can also own public investment projects fully or partially upon reaching agreement (as in the case of Colombo Financial

City project) or simply by purchasing the project fully or partially (as in the case of Hambantota Port project). Sri Lanka has elevated itself to the middle-income level so that it was no longer eligible for foreign loans on concessionary terms either from bilateral or multilateral sources. Therefore, according to Ministry of Finance (2015:141), out of the total USD 1.5 billion foreign financing disbursements in 2015, over 95 percent consisted of commercial borrowings, leaving less than 5 percent as concessionary loans.

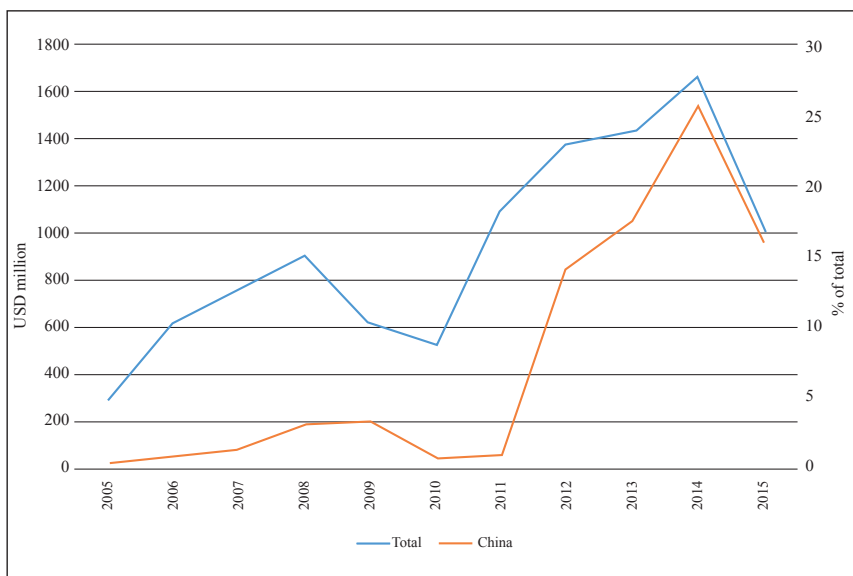
Foreign Direct Investment

As part of the policy reform process, the Government opened the economy for FDI in 1977. This was accompanied by an introduction of an attractive incentive package with tax concessions, relaxation of regulatory barriers limiting foreign investment, and the establishment of an institutional mechanism to facilitate such foreign investment. In most of the countries in Asia, the investment climate in the context of closed economy models, were still not conducive to attract FDI, while Sri Lanka was considered to be one of the most attractive investment center in the region (Athukorala and Jayasuriya 1994). With annual FDI flows under USD 1 billion until 2011, Sri Lanka continued to perform poorly in the area of FDI inflows (Figure 2).

It was during the last five years (2011-2015) that there has been a major breakthrough in FDI inflows to Sri Lanka, and in which China has played a major role. While annual FDI inflows to Sri Lanka increased over USD 1 million since 2012, China has been playing a major role in the recent upsurge in FDI inflows. FDI from China has reached 25 percent of total FDI inflows in 2014, revealing the potential rise in the years to come provided that the investment climate would continue to improve.

China, Hong Kong, Mauritius, UK and India were the top 5 source markets for FDI inflows to Sri Lanka in 2015. They together accounted for more than half of total FDI inflows (Table 5). Being on the top of the list, the Chinese FDI amounted to about USD 990 million, accounting for 15.5 percent of total.

Figure 2 : Foreign Direct Investment Inflows to Sri Lanka, 2005-2015



Source: Board of Investment in Sri Lanka

Table 5 : Major Source Markets for Foreign Direct Investment in Sri Lanka 2011-2015

	USD million	% of total
China	989.6	15.5
Hong Kong	798.7	12.5
Mauritius	579.6	9.1
UK	571.7	9.0
India	477.2	7.5
UAE	426.8	6.7
Malaysia	415.3	6.5
Netherlands	414.0	6.5
Singapore	385.7	6.0
USA	218.9	3.4
British Virgin Islands	137.0	2.1
Luxemburg	124.7	2.0
Japan	114.0	1.8
Canada	113.4	1.8
Australia	95.2	1.5
Switzerland	61.1	1.0
Total FDI	6,381.5	100.0

Source: Board of Investment in Sri Lanka

Public Investment Funding

Foreign funds from China have become a major source of foreign project loans for the Government's public investment programme. Sri Lanka has increased its foreign project loans during the past 10 years from USD 1 billion disbursement in 2005 to USD 3.7 billion in 2015 (Figure 3). The Government has also increased public investment in infrastructure development, including large scale projects such as power generation, expressways, airports, seaports, roads and railways, and reconstruction activities followed by the ending of the conflict in the Northern and Eastern provinces.

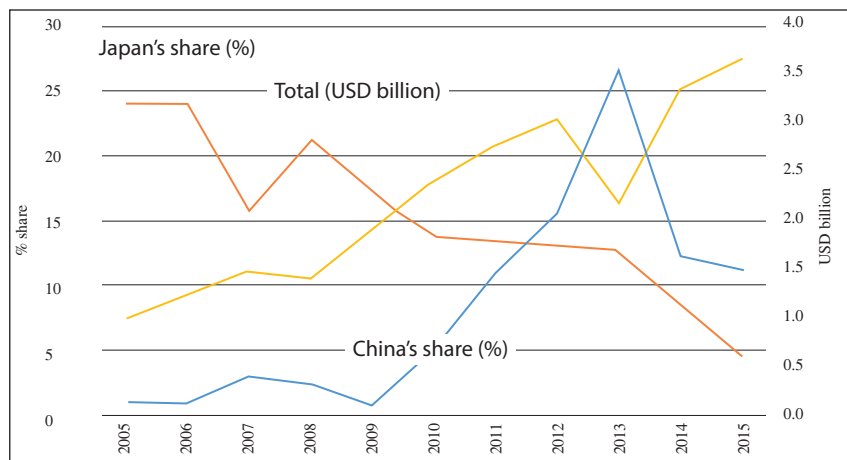
The share of foreign funding from China increased rapidly from 1 percent of total foreign funds in 2005 to 27 percent in 2013. During this period, China has become the largest donor to Sri Lanka after 2012, replacing the position traditionally held by Japan.

China, Japan, Iran, India and France are respectively the top 5 countries among the bilateral donor countries of Sri Lanka. Out of the total bilateral funding commitments, which amount to over USD 5 billion, China accounts for 42.8 percent, and Japan 24.2 percent (Table 6).

Both FDI as well as foreign financing for public investment from China have been important for Sri Lanka's future development process. In general, being a developing country at a lower middle-income level and a smaller country with just 20 million population, Sri Lanka needs to find its own ways and means of filling its wide savings gap. In this context it was China that offered its FDI as well as project funding. Sri Lanka also provided its ideal locational advantage for China's global concept of "Maritime Silk Road" that connects East and Southeast Asia with Middle East and Africa.

However, Sri Lanka erred by not preparing the groundwork adequately for the economy to take off, although the country's civil conflict that constrained long-term growth ended in 2009. As a result, the rate of returns to some of the large-scale investments remained questionable, while public debt soared reaching the level of Government's total tax revenue. As a way out in 2016, the Government was contemplating to convert debt into equity with respect to some of the investment projects. This would mean that with the sale of investment projects, their associated public debt becomes private investment. While this initiative would reduce public debt and improve the much needed foreign exchange inflows, from a long-term point of view it would also enhance the efficiency and competition with better management in such investment projects.

Figure 3 : Public Investment: Disbursement of Foreign Funds, 2005-2015



Source: Ministry of Finance, Annual Report

Table 6 : Main Bilateral Lenders as Committed Financing by the end of 2015

	USD million	% of total
China	2254.6	42.8
Japan	1273.3	24.2
Iran	399.4	7.6
India	326.7	6.2
France	164.2	3.1
Saudi Fund	136.0	2.6
Russia	134.7	2.6
UK	100.1	1.9
South Korea	85.0	1.6
Netherlands	72.8	1.4
Kuwait	61.9	1.2
Spain	58.7	1.1
Total Bilateral	5262.0	100.0

Source: Ministry of Finance, Annual Report 2015

Tourist Arrivals from China

Tourism industry is special among economic activities as it produces and bundles tourist services comprising a range of enterprises, establishments and organizations providing goods and services to meet the requirements of tourists. Consistent with the sluggish performance in many other areas of development, tourism sector in Sri Lanka did not progress for many years. It is also a sector that is more sensitive to the internal security conditions. Consequently tourist arrivals remained limited to about half a million and the industry remained in depressed condition.

The tourism industry made a breakthrough after 2009 as tourist arrivals increased 4 times reaching 1.8 million in 2015 (Figure 4). Along with that, during the same period, earnings from tourism increased from USD 349 million to USD 2980 million, and hotel occupancy rate from 48 to 75 percent (Sri Lanka Tourism Development Authority 2015).

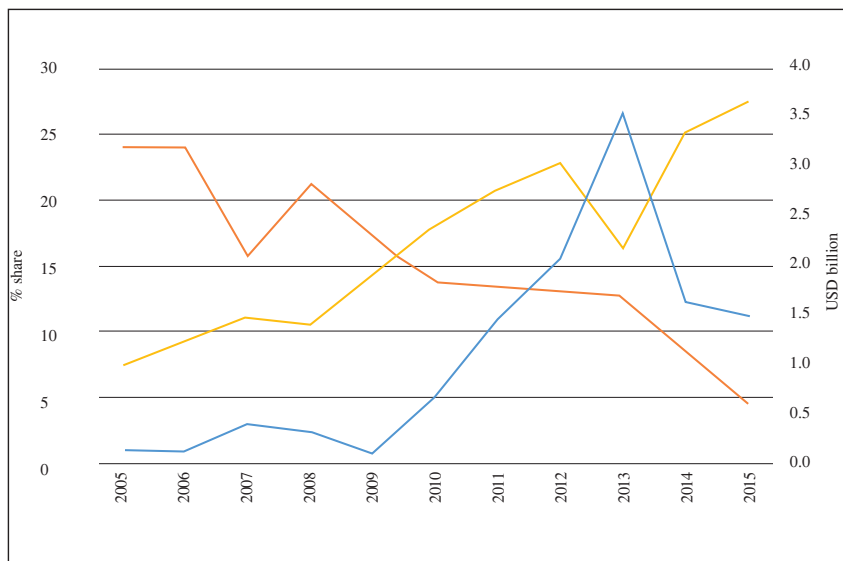
In terms of tourism trends, tourist arrivals from India continued to grow fast after 2000. This was a result of implementing ‘on arrival visa’ policy by Sri Lanka and the implementation of the bilateral Free Trade Agreement with India in the same year, 2000. Accordingly, tourist arrivals from India grew rapidly replacing the traditional tourism source market countries in Western Europe such as the UK and Germany. However, as a share of the total, arrivals from India began to decline from 23 percent in 2006 to 15.5 percent in 2015.

Tourist arrivals from China that remained around 2 percent of the total increased sharply during the past 3 years, reaching 12.5 percent in 2015. The top 5 source market countries for tourist arrivals are India, China, UK, Germany, and France which together account for more than half of the total number of tourists arriving in Sri Lanka; top 10 countries

account for two-thirds of the total (Table 7). The average number of days the tourists spend in Sri Lanka varies. Western tourists stay longer than the average for all tourists which is 10.1 days. Among the Asian tourists, the Chinese stay a longer duration of 9.5 days.

As Sri Lanka is getting ready to accommodate a massive increase in tourist arrivals within the coming years, China is already showing the signs of growing to be the top tourism source market of Sri Lanka. The challenge for our hotel industry is the limitations of hotels, logistics as well as the skilled labour force. All of this cannot be made available within a short period of time.

Figure 4: Tourist Arrivals in Sri Lanka, 2000-2015



Source: Sri Lanka Tourism Development Authority

Table 7 : Top 10 Tourist Source Market Countries 2015

	Arrivals	% of total	Duration of stay (days)
India	278	15.5	5.8
China	224	12.5	9.5
UK	176	9.8	14.7
Germany	125	7.0	15.1
France	97	5.4	13.0
Maldives	95	5.3	8.9
Australia	64	3.6	10.7
Russia	64	3.5	10.5
USA	53	3.0	12.7
Japan	45	2.5	8.6
Total	1,798	66.4	10.1

Concluding Remarks

The preceding analysis was on key areas of bilateral economic ties between China and Sri Lanka from a Sri Lankan perspective. The key areas where the economic ties between the two nations have been deeper and stronger are identified in the study as bilateral trade, investment and finance, and inbound tourism. In all these areas, China appears to have been growing as the biggest source market for Sri Lanka, while in each case, as the analysis revealed, there are imperative policy implications for Sri Lanka. In all these areas, Sri Lanka in general appears to have performed far poorer than its potential, while China has played a major role in bringing about a breakthrough.

Sri Lanka's modern economic ties with China began in the context of friendship manifest since the establishment of the People's Republic of China in 1949 and the independence of Sri Lanka in 1948. Bilateral trade between the two nations continued to remain stronger during the

early years, but mostly confined to the exchange of two commodities – rubber and rice, under the Rubber – Rice Pact of 1952 which was effective for three decades. Trade relations between the two nations began to flourish since the early 2000s, as China has quickly elevated itself to be the second largest source market for Sri Lanka’s imports. The country’s dismal export performance over the past 15 years is reflected through its weak export expansion into China too. The two countries are negotiating a bilateral free trade agreement, but Sri Lanka needs to put its house in order through policy reforms in order to fully realize the benefits of free trade with China.

China has also become the biggest FDI supplier as well as the biggest financier for public investment projects in Sri Lanka. In terms of FDI inflows too, Sri Lanka has not performed well, indicating the weaknesses in the business environment. This again points to the fact that the country needs to strengthen its policy reform process while improving policy consistency and predictability. China has extended extensive financial assistance to a series of Government public investment projects. Given the weak policy environment, the country was unable to realize the anticipated returns from some of these investments. Consequently, the public debt burden continued to rise. The current policy initiative of converting public debt into equity is commendable not only because it would relieve the debt burden, but also because it would improve the efficiency and competitiveness of public investment projects.

China is also about to become the largest source market for inbound tourist arrivals in Sri Lanka. This is another important area where Sri Lanka performed poorly for three decades. The recent upsurge in tourist arrivals and earnings from tourism can overwhelmingly be sourced to China. Given the anticipated expansion in tourist arrivals, Sri Lanka needs to be ready to accommodate few millions of tourists in the medium-term overcoming the challenges of capacity limitation.

While China is rapidly becoming an important source market for Sri Lanka's bilateral economic ambitions, Sri Lanka has the potential to offer its long-established liberal policy regime and locational advantage for China's global vision based on the concept of Maritime Silk Road. China would assist Sri Lanka to realize its national development vision and become the future shipping, logistics and even the financial center at a strategic point of the Maritime Silk Road. On the part of Sri Lanka, this requires putting the economy back on track with a bold purposive reform process that would enhance its competitive business environment and liberal policy regime

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THE SRI LANKAN ECONOMY: OPPORTUNITIES AND CHALLENGES

*Dr. Indrajit Coomaraswamy**

The Sri Lankan economy is at an inflection point. There is considerable potential to place the economy on a path of accelerated growth and development. Equally, there are challenges which need to be addressed.

The opportunities are based on Sri Lanka's resilient economy; policies supportive of growth and employment; its educated workforce; strategic location and connectivity; preferential access to large markets; fast developing infrastructure; and the increasingly vibrant business environment.

The challenges include moving Sri Lanka out of the unsustainable "twin deficit" (budget and current account of the balance of payments) category through: fiscal consolidation; developing a new growth model which fosters sustained expansion of economic activity and employment generation; an improved investment climate and trading environment which improves productivity/competitiveness; and skilling of the workforce to support a rapidly modernizing economy.

** BA (Hons), MA Cambridge University, UK; MA, DPhil, University of Sussex, UK; Former Deputy Chairman, Pathfinder Foundation. This paper was commissioned and completed by the author prior to his appointment as the Governor, Central Bank of Sri Lanka.*

Stabilising the Economy

The budget deficit has been the main source of instability in the system in the post-1978 era. The current account has been in deficit in every year since 1987. This has led to an accumulated debt problem which has increased the risks associated with the Sri Lankan economy. The country has been able to “live beyond its means” as it was a “donor darling”, which had access to large quantities of highly concessional official development assistance (foreign aid). Today, there is a new paradigm as it is a lower middle-income country which is no longer eligible for highly concessional assistance. There is also increased exposure to rating agencies and international capital markets. This places a very high premium on sound macroeconomic management.

In the past, excess demand pumped into the economy by the Government’s fiscal operations has fuelled inflation and exerted pressure on the balance of payments. This has inevitably led to an over-heating of the economy and subsequent compression of domestic absorption through a stabilization programme. The consequence has been repeating cycles of stop-go policies. The post-1978 economy can be caricatured as a high fiscal deficit, high inflation, high nominal interest rate and over-valued currency economy. This is diametrically the opposite from the successful economies of East and South East Asia.

Sri Lanka’s persistent fiscal deficits have resulted in fragile debt dynamics. Debt as a percentage of GDP amounts to 76% (2015). The corresponding figures for comparator countries are: Malaysia: 57.4%; Philippines: 37.1%; and Thailand: 43.1%. The median figure for peer countries with a similar rating is about 40%. Not only is Sri Lanka very much an outlier in terms of the size of its debt stock but the composition of the debt has also changed, thereby increasing vulnerability. The share of external debt has increased and within that there is also a relatively high level of short-term debt. Total debt servicing now accounts for

over 90% of revenue and there has been a primary deficit. The external debt service ratio (as a percentage of export earnings) is 27%, above the prudential norm of 20%.

There is neither fiscal space nor a cushion in terms of external reserves. Resilience has to be built through fiscal consolidation; increased foreign exchange earnings (exports of goods and services) and larger non-debt creating foreign inflows, particularly FDI.

The Government has embarked upon concerted remedial measures. Fiscal reform is at the centre of the Government's stabilization programme and revenue growth is at the heart of the fiscal reform. The reform programme is being supported by an IMF Extended Fund Facility (USD 1.5 bn). The EFF provides some financing but more importantly it catalyses other bilateral and multi-lateral funds, as well as providing increased access to international capital markets.

There has been a sharp fall in total revenue from over 20% of GDP to 11.4% in 2014 and 13% last year. The corresponding figures for comparator countries are: Malaysia 22.2% of GDP; Philippines 19.4% and Thailand 22.6%. Priority is being attached to strengthening revenue mobilization. VAT has been increased from 11% to 15% and some exemptions have been eliminated. The Government plans to introduce a new Inland Revenue Act. The intention is to move to a simpler and fairer system which widens the tax base. There is expected to be a shift from the current 80 – 20% indirect/direct tax mix to a 60/40% outcome. The complex regime of tax relief is likely to be replaced by up-front investment linked incentives and a low tax regime. Improvements in tax administration are also in the pipeline. The key components of this will be greater digitalization through the Revenue Authority Management Information System (RAMIS) and the greater decentralization of tax collection.

A number of measures are also expected to be introduced to strengthen public expenditure management, including the adoption of ITMIS next year. The overall level of expenditure is sustainable at 20.3% of GDP in 2015. The corresponding figures for comparator countries are: Malaysia (25.3%), Philippines (19.4%) and Thailand (22.3%). It is noteworthy that Malaysia has a deficit of 3% of GDP and the other two countries balance their budgets. On the expenditure side, the focus is expected to be on improving its quality and composition, while mainstreaming sustainability; social inclusion and gender parity.

In the current constrained fiscal environment, it has been announced that there will be greater recourse to PPPs (particularly BOT) and alternative off-balance sheet financing, such as securitisation and structured financial instruments.

The Government has also embarked upon a programme of SOE reform. Sri Lankan Airlines is being restructured and expressions of interest have been received from potential strategic investors. A number of non-strategic assets (hotels and commercial real estate) are in the pipeline for divestment. Other loss-making SOEs are being restructured, including through improved corporate governance. There is also the intention to establish a holding company similar to Temasek (Singapore) in order to drive the increased commercialization of the SOE sector.

The trajectory of fiscal consolidation envisages the fiscal deficit to be 5.4% of GDP in 2016; 4.7% in 2017 and 3.5% in 2020. The EFF performance targets (budget, inflation and net international reserves) have been met for June and September 2016. The authorities have indicated their confidence that the IMF Executive Board Review, in November 2016, will result in the programme being kept on track.

Fiscal consolidation is expected to make the conduct of monetary and exchange rate policies less challenging. It becomes easier to deliver

low and stable interest rates and a competitive and stable exchange rate, when the budget deficit is not pumping excess demand into the system.

On monetary policy, the authorities have indicated a move to a forward-looking monetary policy which is set within a medium-term framework. It has also been announced that a flexible inflation targeting regime will be adopted reflecting a shift from a system, which is currently focused on monetary aggregates. In addition, it is important to maintain a competitive real effective exchange rate in order to support the export expansion, which is necessary for boosting growth and employment, as well as servicing external debt.

More stable fiscal outcomes also make it easier to have greater predictability and consistency in the overall policy framework. Ad hoc changes in policy have often been driven by cash flow challenges confronting Government fiscal operations. It is encouraging that the fiscal targets have been met so far, in 2016, despite the VAT disruption.

The external account has been characterized by deficits in the current account of the balance of payments. Unlike the successful countries of East and South East Asia, Sri Lanka has not been able to drive sustained growth through surpluses in the current account. The major weakness has been the structural deficit in the trade account. Sri Lanka's export performance has been disappointing. Exports were USD 1.9 bn in 1990 and amount to USD 10 bn today. During the same period Vietnam's exports increased from USD 2.4 bn to USD 162 bn. There has been a lack of product and market diversification and little progress has been made in boosting the complexity of the export structure. The large trade deficit has been offset by increased earnings from tourism and remittances (almost 10% of GDP). The current account deficit is expected to be 2.5% of GDP in 2016 and 2% next year. Reserves continue to be too dependent on borrowed financing.

New Growth Model

Robust macroeconomic fundamentals are essential for sustained growth, employment generation and poverty reduction. As argued above, stabilization based on fiscal consolidation is crucial to achieve this. However, stabilization is a necessary but not sufficient condition for sustained growth. One also needs to strengthen the supply side of the economy to accelerate growth; create one million livelihoods and increase the incomes of the people.

In this connection, the Hon Prime Minister's Statement (27th October, 2016) spells out a vision which involves the private sector being the locomotive for growth and employment creation. Exports and FDI will be key pillars of the new model for increasing growth, employment and incomes. Previously, the main impetus for economic activity was based on foreign commercial borrowing financed public investment in infrastructure development. This model has run out of headroom due to a lack of fiscal space and the fragile debt dynamics. The new approach, which gives priority to exports and FDI, is being promoted in the context of the "new mediocre" of low global growth and sluggish international trade. However, Sri Lanka's strategic geographical location and excellent international relations, including with the capital surplus countries in East and South East Asia, offset the less than promising global economic context. In this connection, it is pertinent to point out that Sri Lanka is 20 miles from India, the fastest growing large economy in the world, and in the middle of China's maritime silk route.

There are pragmatic economic justifications for adopting a development strategy which prioritises the private sector, exports and FDI. The lack of fiscal space and the public debt burden rules out a "statist" approach. Private investment, domestic and foreign, has to take the lead in transforming the economy while the State plays an important

role in setting the rules, regulations and standards; as well as ensuring the inclusiveness and environmental sustainability of the development path.

In addition, a domestic market of 21 million persons cannot support growth of 7% plus on a sustained basis. Sri Lanka has to be more successful in penetrating international markets, including global and regional value chains. It is important to “earn” rather than “borrow” foreign exchange to meet our import needs, service debt and build the international reserves required as a buffer (insurance) in an uncertain world. All the successful East and South East Asian countries adopted an export-led growth model. It is noteworthy that the World Bank’s Systematic Country Diagnostic found that the Sri Lankan economy is as “closed” today as it was in 1970. A significant amount of the opening of the economy which had taken place has been reversed in recent years largely through a plethora of para-tariffs. These need to be eliminated over the medium-term while managing the impact on Government revenue.

Increased FDI is necessary as the country needs more non-debt creating foreign inflows to fill the savings investment gap, which amounts to about 5% of GDP (USD 4 bn). FDI also brings in technology, markets, branding and know-how. Sri Lanka is attracting less than 1.5% of GDP as FDI, even seven years after the end of the conflict. Countries like Malaysia, Thailand and Vietnam have attracted three or four times that.

One may conclude that a private sector driven development model, with exports and FDI as key pillars is the most appropriate option given Sri Lanka’s specific circumstances. It offers the best prospect for achieving the Government’s target of creating one million livelihoods. Inclusion can be promoted by empowering people through education, training and skills development so they can participate in the new growth sectors in the economy. Promoting SMEs and increasing agricultural productivity

is also an important part of this narrative. This can be supported by a well-designed, targeted and technology driven social safety net to protect the poor and vulnerable through income transfers rather than subsidies which distort relative prices and lead to a misallocation of financial and human resources. The National Identity Card scheme, very high mobile penetration and the number of persons with bank accounts provide a sound foundation for the biometric card driven system which is being proposed.

Sri Lanka is a signatory to the SDGs and the Paris Declaration. Hence, it is important to mainstream sustainability and poverty elimination into the planning and budgetary processes.

Fostering a Competitive Economy

Improving the Investment Climate

Sri Lanka is ranked 110 in the World Bank's Doing Business Index (DBI). Priority needs to be attached to improving performance in areas, such as enforcing contracts (163); paying taxes (158); registering property (155); and getting credit (118). The Central Bank of Sri Lanka is coordinating a process which involves 10 Task forces each of which comprises all the stakeholders for the different pillars of the DBI. The target is to raise Sri Lanka's ranking to 70 by 2020.

Investment Promotion

A one-stop-shop has been established at the BOI and performance improvement is being driven through a set of TORs developed with the assistance of the World Bank. There will be a focus on both attraction and facilitation. There is also a review of investment laws and incentives.

Trade Policy

A national trade policy framework is being developed involving consultation with stakeholders. Tariffs and para-tariffs are being reviewed.

Trade agreements are being negotiated in relation to preferential access to large markets. The current bilateral agreement in goods with India is being developed and widened; the FTA with Pakistan is being invigorated; and new partnership agreements are being negotiated with China and Singapore.

Negotiations are underway to extend the Indo-Lanka Agreement to an Economic and Technical Cooperation Agreement which adds services, investment, technology and training to the current FTA in goods. It is important to address FTA-related outstanding issues such as non-tariff measures; quotas on apparel, tea and pepper, and a Mutual Recognition Agreement before signing the ETCA. The General Sales Tax (GST), which will create a single market in India; improving infrastructure in both countries which reduces transactions costs thereby increasing value chain opportunities associated with the Make-in-India strategy; as well as the favourable prognosis for the Indian economy in the medium and long-term are all supportive of the case for deepening and widening bilateral relations.

The partnership agreement being negotiated with China offers the prospects of increased access for Sri Lankan exporters to its enormous market at a time when the economy is being rebalanced to boost domestic demand. Apparel, tea and rubber goods are some of products that stand to benefit. The real prize will be preferential access to large markets, such India and the EU and Sri Lanka's strategic location that can be offered to Chinese investors in relation other lucrative markets, such as the Middle East and East Africa.

The FTA with Pakistan is being deepened. With preferential access to both the Indian and Pakistani markets, Sri Lanka can act as a bridge for investors from both countries to penetrate each other's markets. Sri Lanka can compete for some of the trade that is currently taking place through Dubai.

A partnership agreement is also being negotiated with Singapore. The potential benefits are likely to be in services, investment and training.

The Hon Prime Minister has indicated that the EU's GSP Plus Agreement is likely to be restored in October 2017. A five-year trade and investment promotion plan is also being developed with the US.

The upshot of all this is that by mid-2017, Sri Lanka is likely to have preferential access to a market of over 3 billion people; coupled with its strategic location, this is the country's "Unique Selling Point".

Trade Facilitation

Documentation is being simplified and the ASYCUDA World-Electronic Single Window for Customs is being introduced.

Trade Adjustment Package

The Government will work with the World Bank and ITC (with EU support) to develop a trade adjustment package which will assist domestic industries to improve their competitiveness and provide retraining opportunities for workers.

Major Projects

The Government intends to develop Sri Lanka as an air-sea hub. Sri Lankans have been traders in the middle of the Indian Ocean for

Millennia. This strategy constitutes a return to the country's ancient roots after periods of disruptive colonisation and inward-looking strategies.

Development Corridors

A major part of the Government's programme will be two development corridors, as announced in the Hon Prime Minister's Statement (27th October, 2016). The two development corridors will be based on the halves of the country influenced by the two monsoons.

The South-Western corridor will be developed around the Southern Highway and the proposed Colombo – Kandy expressway. It will benefit from having the logistical hubs at the Colombo Port and Katunayake Airport. The project has three large components;

- development of the Western Region Megapolis with an eventual population of over 8½million. The project will involve, inter alia, transport and other infrastructure; commercial and residential real estate; logistical hubs; and a techno-city.
- an international financial centre on the land reclaimed under the Port City project.
- a Sub-corridor that will stretch along the central highlands from Kandy via Nuwara Eliya to Badulla and linked to the Kandy Colombo highway. This area will cover the plantation economy which is being revitalized; modernized agriculture based on farmer cooperatives/companies; as well as tourism and service – delivery activities.

- China will play a major role in developing the Hambantota area. There is agreement in principle for a Chinese company to acquire an 80% stake in the Hambantota Port (SLPA 20%). A similar deal is being negotiated for Mattala Airport (the proceeds of these transactions will create opportunities for much-needed liability management on both foreign and domestic debt). 15,000 acres are also being earmarked for industrial zones and assist in stabilizing interest and exchange rates.

The North-Eastern development corridor will connect the Eastern Province and the North Central Province to Jaffna, linking the Trincomalee Port to the Rajarata. The completion of the Moragaha Kanda and Malwatu Oya reservoirs will create more land for agriculture. Trincomalee is expected to be transformed into a major port city and the plans envisage Anuradhapura and Polonnaruwa emerging as modern urban centres. Reconstruction of housing and civic infrastructure is being given priority in war-affected areas around Jaffna, Kilinochchi and Mullaitivu.

Social Inclusion and Sustainable Development

Education, Training and Skills Development

It is important to align the economic sub-sectors, which have a dynamic comparative advantage, with the labour market and the provision of education, training and skills development. A new thrust is being implemented for making 13 years of education mandatory. A new initiative will be the provision of vocational training for students who do not continue higher education after 'O' Levels. A programme has also been launched for early child development (pre-schools).

Housing

Priority is being given to the right to shelter. The Rural Housing Loan Programme, Urban Regeneration Housing Programme and the Estate Housing and Resettlement Programmes are being implemented addressing the needs of different vulnerable groups. The plan is to construct 500,000 housing units for middle-class families in urban and sub-urban areas; 65,000 houses for the urban underserved population; 65,000 people for IDPs in the conflict-affected areas; and meet 65% of the estate housing requirement by 2020.

Social Infrastructure

Other focus areas include solid waste management in urban areas and provision of safe drinking water for part of the country which require it.

Financial Inclusion

A national financial inclusion policy is to be developed through the Central Bank of Sri Lanka. The passage of the Microfinance Act, the consolidation of rural development banks and a new Rs 4 bn MSME credit scheme are expected to promote financial inclusion as a means of fostering entrepreneurship in the country.

Conclusion

The country is seeking to implement a development programme designed to meet the multiple objectives: economic prosperity, social justice, environmental sustainability and gender empowerment. The key challenge will be effective implementation. It is important to build a national consensus and involve all stakeholders. Sri Lanka was second

to Japan in Asia on most indicators at the time of independence. Today, it has slipped behind several other countries. Many opportunities have been lost during the last 68 years. The current historical conjuncture holds considerable promise. The opportunities have to be grasped. That is the challenge for all Sri Lankans.

CHINA – SRI LANKA ECONOMIC AND OTHER RELATIONS: A WAY FORWARD

*Dr. Zhao Hongtu**

The great rejuvenation of the Chinese nation has been China's dream since entering into modern times. To achieve the dream, the Chinese Communist Party (CCP) has gradually developed the "Two One-Hundred Years Goals". The first is to complete the building of a moderately prosperous society by 2021 when the CCP celebrates the 100th anniversary of its founding. The second is to complete the building of a prosperous, democratic, civilized and harmonious socialist modern country by 2049 when the People's Republic of China (PRC) celebrates the 100th anniversary of its founding.

Since opening up in late 1980s, China's development can be divided into four phases: First was the extreme low income period (1978-1990), focusing on food and clothing for 1.1 billion people; Second was the low-income stage (1991-2000) entering a society of low level or elementary prosperity. Third was the lower middle income country (2001-2010) getting into the period of building a moderately prosperous society with a per capita GDP reaching 4300 US dollars.

**Research Professor in International Political Economics, Institute of World Economic Studies, China Institutes of Contemporary International Relations (CICIR). PhD and MA (Institute of International Studies, East China Normal University), BA (Hebei Normal University). Served as a Visiting Fellow at University of Wisconsin-Madison (United States), Secretariat of Energy Charter (Brussel).*

Since 2010, China has become a higher middle income country making steady progress towards completing the tasks of achieving a moderately prosperous society. The key target is to double its 2010 GDP and per capita income for both urban and rural residents, with per capita GDP overtaking 8000 US dollars by 2015 and 12000 US dollars by 2020, to be or close to be higher middle income economies. Next five years will be the key stage of achieving a moderately prosperous society, according to the “13th Five Year Plan”.

Following the principles of innovation, coordination, green economy, openness and sharing, China aims to achieve the social and economic development objectives as follows:

Medium High Economic Growth

To make economic development more balanced, inclusive and sustainable, it's very important to push forward economic structural adjustments and industry upgrading, strengthening agriculture modernization, and increasing the share of advanced manufacturing, emerging strategic industries as well as service sectors. In order to make development innovation driven, it's crucial to pursue the extensive application of information technologies in industrialization, positively develop new economies and new types of business as well as new fields.

To achieve the goal of doubling the 2010 GDP and per capita income for both urban and rural residents by 2020, the annual economic growth rate should be over 6.5 percent during the next five years, and the GDP should be over 90 trillion RMB. During the 13th “Five Years Plan” period, the share of the service sector contribution to the GDP would be increased from 50.6 percent in 2015 to 56 percent by 2020. The share of employment in the service sectors is to increase from 40.6 percent in 2014 to 46.6 percent by 2020, while the share of agriculture is decreased to 23 percent.

Innovation Driven Development

In order to encourage innovation in enterprises, technology and economy must integrate, and achieve breakthroughs in important fields and key technologies, greatly improve labour productivity. This is the way forward to an innovative country. By 2020, the contribution of scientific and technological progress to economic growth is to reach 60 percent, the total expenditure on research and development will increase to 2.32 trillion RMB from 1.42 trillion RMB in 2015, the share of expenditure on research and development would be increased from 2.1 percent of GDP to 2.5 percent. The total investment in next five years would be 11.22 trillion RMB.

During the 13th Five Year Plan period, China plans to launch “Scientific and Technological Innovation 2030”, which includes six important programs like deep-sea work station or deep-sea station (underwater ‘space station’) as well as quantum communication and quantum computer, nine important projects like clean use of coal, smart grid, big data and intelligent manufacturing etc. A number of high level national scientific centers and technology innovation centers will be built. The number of invention patent per ten thousand people will be increased from 6.3 in 2015 to 12 by 2020. The total number of patents in China would be increased to 1.68 million from 1.19 million. Internet coverage rate will be greatly improved, the fixed broadband coverage rate will rise to 70 percent by 2020 from 40 percent in 2015, and the total number of users will increase from 688 million to 980 million. The mobile broadband coverage will increase to 85 percent from 57 percent, and the total number of users will increase from 780 million to 1199 million.

Coordinated Development

In pursuance of the policy of new urbanization and agriculture modernization aiming to narrow the gap between the cities and

countryside, coordinated development between cities and countryside will be pursued. This will include enhancing the contribution of consumption to economic growth, greatly improving the efficiency of investment, furthering the depth and width of openness, improving the exporting structure, etc.

Improving other measures will include the quality of urbanization, and increasing the urbanization rate of registered residents. By 2020, the urbanization rate of permanent residents will be 60 percent, total population will be 840 million, an increase of 70 million than in 2015. The reforms of household registration will be expedited, and the policy of residence certification will be launched. By 2020, the urbanization rate of registered population would be increased to 45 percent, and the total registered population would be over 630 million.

Strengthening the building of important infrastructures, and narrowing the gap between different regions will be undertaken. By 2020, the relative coefficient of variation per capita GDP in different regions is expected to fall below 40 percent. The coverage of high speed railway reaches 30 thousand kilometers, covering more than 80 percent of big cities; The length of express ways will be 150 thousand kilometers and 152 thousand kilometers of asphalt roads (or cement roads) will be built in villages; under the “Broadband China” project designed, to achieve the goal of 98 percent of the villages having optical fiber connectivity, the broadband coverage in undeveloped villages will be increased to 90 percent. The availability of running water in rural area will be increased to 80 percent.

Significant Rise of Living Standard

The rise of public well-being is not only one of the most important targets of development, but also a driver of sustainable development. In this regard, public service system which includes employment, education,

culture and sports, healthcare as well housing need to be very much improved. Significant progress in in education modernization should be made in the next several years, and the education years of working age population will be significantly increased. The ‘target’ also includes full employment, reduction of income gap, and the rise of middle income population. Most important and ambitious goal is to eradicate rural poverty under the current standard (Annual consumption is lower than 2300 RMB, in 2010 instant price, around 2.19 US dollars).

From 2010 to 2015, China’s rural population in poverty decreased by 109.92 million, from 165.67 million to 55.75 million. The target of 2020 is to lift all of these people out of poverty. Education modernization has advanced significantly, and a number of world class universities and curricula will be developed; The education attainment years of working age population is increased to 10.8 from 10.23. The per capita life expectancy will be increased from 76.34 in 2015 to 77.34 by 2020. Infant mortality will be decreased to 0.8 percent, while maternal mortality is reduced to 18 per 100 thousand.

To achieve the goal of full employment, 50 million new jobs will be created in the next five years. By 2020, the gap of per capita disposable income between urban and rural areas will be reduced from 2.73 times to 2.35 times, the GINI index of total residents will decline from 0.462 to 0.45. The coverage of basic pension insurance will increase from 82 percent to 90 percent, and the coverage of medical insurance will be over 95 percent. 20 million houses will be rebuilt in shanty areas, and shanty towns to be eradicated by 2020. The coverage of indemnificatory housing will reach over 20 percent, by 2020.

Great Improvement to Ecological Environment

Green production and life style as well as low carbon emission, are very important parts of “Beautiful China”. To this end, the efficiency of

energy and resource production and development should be improved very much, and the emission of main pollutant needs to be significantly reduced. By 2020, the total amount of energy consumption would be contained below 5 billion tons standard coal equivalent. The clean use of coal needs to be pushed forward, and the coal should be replaced by electricity and natural gas. Strengthening the development of clean energy, the share of non-fossil energy accounting for primary energy consumption would be increased to 15 percent from 12 percent in 2015. The energy density per capita GDP would be reduced by 15 percent. The carbon emission per capita GDP would be reduced by 18 percent. A nation-wide and local carbon trade market will be established, and local governments and enterprises will be encouraged to release their own intended targets of carbon emission. The target is to reduce by 2020 the total emission of main pollutants including chemical oxygen, ammonia nitrogen, sulfur dioxide and nitrogen oxide by 10-15 percent and the total emission of volatile organic compound by over 10 percent.

Taking farm land protection as a red line, new land earmarking for building should be controlled below 5.36 million acres. Promoting the efficiency of water use, the water usage per capita 10 thousand GDP (in RMB) is to reduce 23 percent in next 5 years and the total amount of water use should be controlled below 670 billion cubic meters. The commercial logging in natural forests should cease and, the forest coverage will be increased to 23.04 percent by 2020 from 21.66 percent in 2015, In pursuit of the wetland protection and recovery projection, the total national wetland will not go below 131.8 million acres. In order to increase the vegetation coverage rate to 56 percent a new round of grassland ecosystem protection will be supported and subsidized.

CHINA – SRI LANKA MARITIME RELATIONS: OPPORTUNITIES AND CHALLENGES A SRI LANKAN PERSPECTIVE

*Admiral Dr. Jayanath Colombage, RSP, VSV, USP, rcds, psc, PhD, MSc
(DS), MA (IS), Dip in IR, Dip in CR, FNI (Lond)**

The Theatre: The Indian Ocean

The Indian and Pacific oceans are playing a significant role in world affairs in trade, economics, political and strategic areas in the 21st century. The Indian Ocean (IO) is fast becoming the most important ocean in this century and this fact is clearly evident from the attention being given to this ocean by major maritime powers. A ‘Cooperative Strategy for 21st Century Sea Power’ published jointly by the US Navy, US Coast Guard and US Marine Corps, speak about their focus on the Indian and Pacific oceans in this century (2015). This document has strategically divided this ocean space into Indo, Asia and Pacific. Similarly, the Australian white paper also talks about growing prosperity, economic and security significance of the IO (2016). Meanwhile, Japan, South Korea and ASEAN countries also have realized the importance of the IO. The biggest regional power in the IO, India has naturally asserted its intentions by developing naval power projection capabilities in this region. China, which is fast becoming a new economic power, has indicated its intentions to use the IO very clearly. All these factors are

**Former Commander of the navy, Chairman of Ceylon Shipping Corporation and Adviser to the President on Maritime and naval hub.*

providing a clear indication that the IO has assumed great significance in world affairs in this century. The IO features some of the busiest and key strategic shipping routes serving as a conduit for maritime trade between Asia, the Persian Gulf, Africa, Europe and the Americas. The maritime trade is increasing and as per the US cooperative strategy for 2016, “oceans are the life blood of the interconnected global community, where sea borne trade is expected to double over the next 15 years (2015). Many nations depend on the IO for transportation of their energy requirements, which is essential for their economic sustenance. This is a warm water ocean that experiences two well-established monsoons. The warm waters mean a rich diversity of fisheries resources, operability throughout the year and the monsoons that bring the rain and cool the climate. The IO possesses some of the world’s largest fishing grounds, providing approximately 15% of earth’s known catch (Senarathna, 2015).

Sri Lank in the Indian Ocean

Sri Lanka is a small island nation situated at a geo-strategically important location in the IO. Due to this strategic location, Sri Lanka has invariably become part of geo-political and geo-strategic competition in the IO (Silva, 2015). The proximity of the island to the world’s busiest sea route, where East and West meet, offers enormous strategic interest for many countries. The geo-strategic importance of Sri Lanka can be summarized as:

- a. Proximity to the busiest international maritime route;
- b. Epicenter of the IO;
- c. Availability of deep water ports and navigable waters close to shore line;
- d. Possibility of discovering natural gas and oil in the Mannar Basin;
- e. Democratic system of governance;
- f. Ending the conflict, which lasted for nearly 26 years resulting in peace and stability;

- g. Free market economic policies;
- h. Policy initiatives at world stage; IO as a Zone of Peace, formation of SAARC, role in NAM;
- i. Unbiased character; and
- j. Aspiration to be the maritime hub of the region by using its geo-strategic location.

India-Sri Lanka Liaisons

Indo-Sri Lanka liaisons date back to more than 2500 years and India is the geographically closest country to Sri Lanka. There have been close economic, religious and cultural ties with India. Sri Lankan maritime space falls within the Indian security umbrella due to the close proximity and the fact that there is no continuous navigable channel for India around its southern periphery and even Indian naval ships have to go around Sri Lanka to move from the east to west and vice versa. India was the first country to arrive with relief supplies when the devastating tsunami hit the country in 2004. Also, India came to assistance in post conflict reconstruction and development activities in Sri Lanka. India trains largest number of Sri Lankan military officials and has provided non-lethal military aid during the conflict. However, some events, which have taken place in the past, such as facilitating the Tamil militant rebellion at the initial stages, arrival of the Indian Peace Keeping Force (IPKF), poaching by Tamil Nadu fishermen and the attitude of Tamil Nadu politicians have created distrust and suspicion among the Sri Lankans about the true intentions of India. As per the Consulate General of Sri Lanka in Mumbai, “India is also the largest trade partner for Sri Lanka” (2013).

China-Sri Lanka Nexus

Relations with China also date back to thousands of years. There had been long term cultural, religious and economic ties with China. The Ming Dynasty's Admiral Cheng He had visited the Island at least three times with his fleet of ships during the early part of the 15th century. Sri Lanka is one of the first countries to recognize China in 1950, when many nations were in a dilemma whether to grant recognition or not. In 1952, the historical Rubber-Rice Agreement was signed between the two countries. Liyanage states "China has now become Sri Lanka's largest aid donor replacing the traditional donors from Europe, west and Japan" (2010, p.16). China provided military hardware to fight against the LTTE, when there was a de-facto embargo on lethal arms exercised by many countries in the West. During the post conflict period, when there was a strategic vacuum created by India and West citing war crimes, China filled that gap and became the number one development partner. China played a key role in the development of the Southern Expressway, Port of Hambantota, Mattala airport, Norochcholai coal power plant and many other infrastructure projects. There are negotiations for a Free Trade Agreement and to set up an industrial park in Hambantota. China supported Sri Lanka in the UN Security Council deliberations and in Human Rights Council in Geneva, when the West sought to censure the country for alleged human rights violations. China is seen as a time-tested friend of Sri Lanka, who does not interfere in the internal affairs of the country.

China-India-Sri Lanka Strategic Trinity

In order to pursue any important maritime relations with China, it is necessary for Sri Lanka to understand the geo-political and geo-strategic reality of the region. Thereafter, Sri Lanka should craft its foreign policy in order to benefit from the situation. There is an inevitable 'maritime

cold war' brewing up in the IO, among the main spheres of influence of USA, India and China. The USA, the self-proclaimed global policeman, is in the IO stating the need to ensure the freedom of international navigation and trade. India is the most powerful country in the IO in terms of naval and economic power. China is not a littoral state of the IO but depends heavily upon it to secure its energy and raw material requirements from the Middle-East and Africa and to move its finished products to the Middle-East and Europe. China, like any other nation, has the freedom of using the high seas in terms of the United Nations Convention on the Law of the Sea. How Sri Lanka could manage the strategic perceptions of these three key players and go about in win-win diplomatic maneuvers will determine its future in the IO. If Sri Lanka can understand the ends, ways and means, especially of China and India, in pursuit of their wider military, political and economic interests and strategic aspirations of both, it can derive positive benefits. Sri Lanka being a friend of both countries could be a maritime-bridge between China and India. Sri Lanka experienced a bitter separatist armed conflict for nearly 26 years, which retarded the development process. Sri Lanka should now look for multi-dimensional investment from all countries that are interested in investing in the country. Sri Lanka cannot afford to miss this opportunity again and this fact should be clearly made known to all stakeholders. In the contemporary world, security issues are taking precedence, as there are many non-state actors out there, who are pursuing their own agendas. A case in point is the pirate activities in the Horn of Africa, which took the international shipping to ransom. Sri Lanka became a facilitator of efforts by multi-national navies to counter the menace of piracy in the IO. Large number of warships from many nations, from within and outside the IO visited Sri Lankan ports for replenishment. Also, Sri Lanka became the hub of Privately Contracted Maritime Security Companies (PMSC) in the IO and India did not object to this role. Maritime security is of prime concern of the international seaborne commerce. Sri Lanka can be the regional hub of 'maritime

security' to monitor the maritime domain in the IO with its most central location, proximity to main sea lanes, acceptance by all countries, availability of well-trained, highly experienced human resource by fighting and defeating the most ruthless terrorist organization at sea. No single country can handle today's complex maritime security structures and coordinated and collaborative efforts are essential. Security of Sea Lanes of Communications (SLOC) is critical for both China and India and there is a rationale for collaboration. This understanding is crucial at this point of time.

Opportunities and Challenges for China -Sri Lank Maritime Relations

It is now prudent to analyze the opportunities and challenges for China-Sri Lanka enhanced maritime relations, based on the backdrop of the discussion so far in this paper.

Opportunities:

- a. **Proximity to the main ocean trade route in the IO.** Sri Lanka's geographical position close to the busiest shipping lane in the IO is the best advantage it has over any other country. Also the fact that the country is equidistance from the eastern and western littorals in the IO provides ships with an ideal stop for replenishment and cargo transfers. Country's advantage in being close to the main global shipping lane and access to main line operators is a real blessing. "all top 20 Global Shipping Lines call on Colombo" declared minister of Industry and Commerce of Sri Lanka Bathiudeen addressing the World Export Development Forum in May 2016 in Colombo. (Bathiudeen, 2016). This ideal location provides impetus to benefit from the ambitious Chinese Maritime Silk Road in the 21st Century.

- b. **Deep-water ports and navigable water close to shoreline.** This is another major enabler for Sri Lanka to be the maritime hub of the region. Sri Lanka is the only country in the region, where mega container ships carrying more than 18,000 Twenty foot Equivalent Units (TEU) can dock and transfer/load their cargo. Chinese main line operators can now use the Colombo South Port Terminal conveniently. Port of Colombo plays a crucial role in handling transshipment cargo of India and once fully developed the Port of Hambantota also could perform a similar role. Sri Lanka has to maintain this hub status and develop trade with China and other countries. China has already invested in Colombo International Container Terminal (CICT), which is the biggest and deepest container terminal in the region. In addition to the Port of Colombo, the Port of Trincomalee, which is one of the most sheltered natural harbours in the world, is the closest harbor to the Bay of Bengal, with an average depth of 25 meters, and is a gold mine waiting to be developed with infrastructure and cargo handling facilities. Port of Hambantota, when all three phases are completed, will be a multi-purpose, industrial and service port, which is located just 19 km from the world's busiest shipping lane. This port will be ideal for bunkering and provision of other marine services and could benefit immensely from the 21st Century MSR initiative.
- c. **Peace, Stability, democracy and Good Governance.** Sri Lanka has come out of a long drawn out armed conflict successfully and peace now prevails in the country. The country has a well-established democratic system of governance and present government's focus on good governance has won praise from the international community and the systems and mechanisms within the country are being streamlined. This is one of the best environments for investment and trade.

- d. **Visionary Political leadership.** Sri Lanka has been aiming to be a maritime hub since the ending of the conflict in 2009. The current President, the Prime Minister and the Government have declared their desire to capitalize on the important location of the island and the prevailing conducive environment to achieve this objective. Plans are underway to develop the port of Hambantota to its full potential as well as the Port of Trincomalee. There is an open invitation for FDIs and responses are positive. The current government's policies and diplomatic initiatives seem to have created a positive attitude in India and the West. When Indian Prime Minister Modi visited Sri Lanka, he stated, "Two countries can become the engine of regional prosperity. Let us together harness the full potential of the ocean economy" (Address to Sri Lanka Parliament, 2015)
- e. **Unbiased Character.** Sri Lanka has followed a non-aligned foreign policy since independence. This is a great advantage not only in the political arena but also in the trade. Sri Lanka should capitalize on this aspect and be the neutral trade partner for all the nations including China. Sri Lanka should play a positive role in trade dynamics at sea.
- f. **Colombo International Financial City (CIFC).** This is the biggest ever, single project approved by the Board of Investment (BOI) in Sri Lanka. This project should transform Colombo to become the financial hub in the South Asian region and provide large-scale employment opportunities to Sri Lankans. This project will be financed by a Chinese company and it will be a great opportunity to enhance relations across the oceans. This mega project was delayed for more than a year mainly due to external pressure.

- g. **Deep Seabed Mining.** The Exclusive Economic Zone (EEZ) of Sri Lanka has the potential of discovering natural gas, oil and other minerals. This is another opportunity to involve both China and India. Although joint exploration may not be possible due to strained political relations, technology of both the countries may be employed for seabed explorations.
- h. **Humanitarian Assistance and Disaster Relief.** The vast IO is susceptible to man-made and natural disasters due to climate change, tsunamis and El Niño and La Niña phenomena. Also there are regular situations where Search and Rescue (SAR) operations need to be carried out to provide assistance to vessels and people in distress at sea. This is an area where one nation cannot effectively handle on its own and China could play a role in providing necessary technical assistance and cooperation for these efforts.
- i. **Involvement with the ASEAN.** Both Sri Lanka and China have close economic and political relations with some countries of ASEAN. This relationship could be another opportunity for the two countries to enhance their maritime cooperation in association with ASEAN.
- j. **Cultural Footprints.** Both India and China have historical cultural, religious and trade footprints across the IO region including in Sri Lanka. These commonalities should be used to develop mutual trust and confidence and for development of the IO region through comity.

Threats:

- a. **Growing Strategic Security Concerns.** The IO has become a place of an undeclared cold war between major players. The mistrust between China and India and concerns of the USA will be a threat

to furthering maritime aspirations of Sri Lanka. This aspect should be carefully addressed specially by China, and Sri Lanka should not show partiality towards any one side. This was highlighted by the Chinese Foreign Minister Wang Yi when he visited Sri Lanka in July 2016 by stating “The two sides will strengthen coordination and collaboration in International and regional affairs and jointly safeguard international justice and fairness. China- Sri Lanka cooperation does not target any third country and does not affect their respective relations with other countries”. (Embassy of PRC in Colombo, 2016)

- b. **Competition for Energy.** Every country needs energy resources. Both China and India are aiming to be economic super powers and hence their success would depend heavily on uninterrupted supply of energy and raw materials. The competition to acquire resources may lead to a conflict of interest between the two countries and may adversely affect Sri Lanka’s ambitions to be a maritime hub.
- c. **China’s Unilateral Action in the South China and East China seas:** China will have to establish that it would follow a ‘rule based maritime order’ in the IO by adhering to international law, as well as internationally accepted norms and principles. If not, there will be doubts about Chinese strategy in the IO. China has to prove to the world that its soft power options in the IO are purely driven by economic interests and not in pursuit of military expansionist objectives.
- d. **Lack of Confidence Building Measures.** Both China and India fear about each other’s maritime ambitions and security of SLOCs and strategic waterways. This has led to a naval capability race of unprecedented nature. They should use their expanding trade relations to allay mutual-fears of maritime competition, enhance mutual trust and demonstrate goodwill.

- e. **Lack of Information about MSR.** Many countries wish to participate in the MSR initiative. However, India feels that it is an attempt to isolate it and take some countries in the IO under the Chinese influence. India plays a crucial role in trade in the IO and should be included in any major maritime venture. The objectives of a “shared destiny and to forge a community of interest with political mutual trust, integrated economies, inclusive culture and interconnectivity” (National Development and Reform Commission of PRC, 2015) should be explained further to enhance prospects of India joining this initiative.

Conclusion

The IO has become the key ocean for international trade in the 21st Century. The major economic powers such as the USA, India, China and Japan depend on the IO heavily for their economic well-being. Sri Lanka is located [in a] geo-strategically [important location] at the center of the IO. This strategic location has trapped Sri Lanka in the power rivalry involving major maritime users. The country has ended a protracted conflict. It needs to accelerate infrastructure and economic development and benefit from the rapid developments taking place in India as well as China. Many opportunities are there to enhance maritime trade with China. There are some challenges too and these needs to be overcome. Sri Lanka should capitalize on its non-partisan foreign policy posture and benefit from the situation by understanding and dealing with strategic concerns of key stakeholders in the IO.

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SINO – SRI LANKA MARITIME COOPERATION: OPPORTUNITIES AND CHALLENGES

*Dr. LOU Chunhao**

As important source of fisheries, hydrocarbon and mineral resources, and also as the primary medium of global trade, ocean is closely linked with human beings' daily life. It's widely believed that "blue economy", referring to ocean-related economic activities, boasts of increasingly vital role in social and economic development. For China and Sri Lanka, ocean has always been one important channel for bilateral cooperation. China is pushing forward "maritime power" and "one belt, one road initiative" (OBOR), while Sri Lanka enjoys significant geographic advantages and huge marine resources potential. Though facing some difficulties, Sino-Sri Lanka maritime cooperation enjoys strategic and structural opportunities. And, maritime cooperation will inject great impetus for bilateral cooperation. China and Sri Lanka should endeavor to make "blue economy" a vital pillar for bilateral cooperation.

** Deputy Director and Associate Research Professor of the Institute of Maritime Studies at the China Institutes of Contemporary International Relations (CICIR); Council Member of the Chinese Association of South Asian Studies. PhD in International Politics and Economics (CICIR), Master and Bachelor's Degrees in International Politics (University of International Relations). Served as visiting scholar at the Institute for Defense Studies and Analysis (IDSA, New Delhi), Australian National University (Canberra) and attended the 2016 Advanced Security Cooperation Course in Hawaii organized by Asia-Pacific Center for Security Studies.*

Part I : Dynamics for Maritime Cooperation

One Chinese proverb goes like this “one hand can’t clap”, so is the case for Sino-Sri Lanka maritime cooperation. There would be no concrete cooperation if each side had no willingness or resources to cooperate.

China is witnessing increasing overseas interests and presence in the Indian Ocean region (IOR) and is eager to deepen cooperation with regional countries, definitely including Sri Lanka. Chinese interests include, but not limited to, the protection of overseas assets, safeguarding of sea lines of communication (SLOCs), and the transformation from a land-locked regional power to an ocean-oriented global power. As to the overseas assets, the past few decades witnessed growing Chinese overseas economic activities, with developing countries of the IOR as important destinations. These interests are facing various security threats, both traditional and non-traditional, with recent cases like the Libya and Yemen crises. Thus, it’s necessary to strengthen front power presence so as to protect overseas property and citizens.

As to the SLOCs, it’s reported that around 90% of Chinese foreign trade is seaborne and the route covering the Indo-Pacific waters is of key strategic importance. It’s estimated that the Indo-Pacific route accounts for around 50% of total foreign trade, 80% of oil imports and also a large proportion of other resources, such as LNG, iron ore, and copper.

As to the transformation, though China has long coastlines and an old history of being a seafaring state, Chinese security strategic thinking has been obsessed with land power for a long time. Chinese maritime orientation was awakened by the “hundred years of humiliation”, propelled by the “open and reform policy”, and advanced to a new stage

by the aim of building “maritime power”.

In the context of the above mentioned interests, it is axiomatic for China to implement the 21st Century Maritime Silk Road initiative (MSR), with maritime connectivity, blue economy, and production capacity cooperation as its pillars.

Sri Lanka enjoys great potential and impetus for maritime cooperation, due to its marine resources, geographic location and domestic development strategy. As to the marine resources, Sri Lanka has a long coastline and around 21.5 thousand km² territorial sea and an Exclusive Economic Zone (EEZ) of up to 200 nautical miles (370 km) from the coastal line-an extent of 517 thousand km²,³⁷ which is around 7 times over its land area. Thus, Sri Lanka has significant potential in developing the blue economy, such as fisheries, marine tourism, resources exploration, etc. It's reported that marine tourism industry contributes over 20% to the Maldives' GDP. This is a good case for Sri Lanka to emulate.

As to the geographic location, Sri Lanka is at the center of IOR and very close to Indo-Pacific SLOCs. Constrained by several decades of internal conflict, Sri Lanka couldn't utilize its location advantages, losing the transport hub status to Singapore. However, since the ending of internal conflict, Sri Lanka places great emphasis on modernizing its ports, mainly those in Colombo and Hambantota , towards making them regional transport hub.

37 Senarathne, “Blue Ocean Economy’ The Future Prosperity of Sri Lanka Lies in The Sea”, December 31, 2013, <http://www.ft.lk/article/234338/Blue-Ocean-Economy-the-future-prosperity-of-Sri-Lanka-lies-in-the-sea>. (Accessed on October 15, 2016)

As to the development strategy, it is widely acknowledged within Sri Lanka that it has to make use of its immense blue economy opportunities, though different administrations may take different measures to that end. It's argued that "increasing the contribution from ocean resources to the economy should be one of the development priorities of the country".³⁸ In this process, Sri Lanka is looking for external help, including technology, funds, development experience, etc. Thus, the Chinese MSR initiative provides golden opportunities for Sri Lanka to develop its blue economy.

Part II : Opportunities and Challenges

As a part of the overall bilateral relations, Sino-Sri Lanka maritime cooperation faces spill-over effects from other aspects. Generally speaking, the opportunities could be summarized as political will, economic complementarities and diplomatic friendship.

First and foremost, both China and Sri Lanka show strong political eagerness for bilateral cooperation. Political trust lays a solid foundation for bilateral cooperation which is strongly reflected in the history of Sino-Sri Lanka bilateral relationship.³⁹ Just like one Chinese scholar has pointed out, "Politically, there is only friendship for Sino-Sri Lanka relationship. The two countries have no incomparable conflicts. This lays the most solid political foundation for bilateral relationship." Since

38 Kanchana Wickramasinghe, "Is Sri Lanka Making Use of Its Ocean Resources for Economic Take-Off?", November 24, 2013, http://www.island.lk/index.php?page_cat=article-details&page=article-details&code_title=92720. (Accessed on October 15, 2016)

39 WU Zhaoli, "Sri Lanka's Domestic Politics' Change and the 21st Century Maritime Silk Road" (*Sililanka Zhengju Bianhua Yu Chongjian 21shiji Haishang Sichou Zhilu*), Annual Report on the Development of the Indian Ocean Region (2015) (Yinduyang Diqu Lanpishu, 2015), Beijing: Social Sciences Academic Press (Shehui Kexue Wenxian Chubanshe), 2015.

the establishment of diplomatic relationship, the two countries showed political trust and good-will towards each other. The Chinese President XI Jinping's state visit in November 2014, twenty-eight years since the last Chinese President's visit, marked a historical milestone in bilateral relationship. During that visit, the two Governments signed many agreements for cooperation, including the development of Colombo Port City, and were committed to jointly build the MSR. Chinese Foreign Minister WANG Yi stated, "Sri Lanka was the first country to support the MSR initiative in the form of a government statement, which is the best interpretation of Sino-Sri Lanka traditional friendship at present".⁴⁰

Following the presidential election in early 2015, Sri Lanka's new Government took a more "balanced" foreign policy view and suspended some projects invested in by Chinese enterprises. There was speculation that the Sino-Sri Lanka relationship witnessed a "U-turn" and the MSR would face a serious setback. However, a more comprehensive and longer-term analysis showed that the basic foundation of the bilateral relationship has not changed, and the troubles some projects faced were temporary ones caused by Sri Lanka's political transition. In fact Sri Lanka's new Government reiterated several times that the suspension of some projects was not against Chinese enterprises and that the current government would actively participate in the OBOR. The Chinese Foreign Minister and a special envoy have visited Sri Lanka, and Sri Lanka's President and Prime Minister have also visited China for fruitful discussions with the Chinese leadership. During the recent visit by Sri Lanka PM Ranil Wickremesinghe, both sides issued a joint statement reiterating clearly that "The Chinese side pledged to continue its assistance to Sri Lanka's economic and social development,

40 "Wang Yi: Expect Sri Lanka to Become Pearl on "Maritime Silk Road of the 21st Century", February 28, 2015, http://www.fmprc.gov.cn/mfa_eng/wjb_663304/zjjg_663340/yzs_663350/gjlb_663354/2782_663558/2784_663562/t1241672.shtml. (Accessed on November 18, 2016)

improvement of people's livelihood.....Sri Lanka reiterated its active participation in the Belt and Road initiative put forward by China, as Sri Lanka was in ancient times, the center of the Indian Ocean trade and, intends to re-establish this status once more.”⁴¹

Second, China and Sri Lanka witness good economic cooperation and convergence of development strategies. According to data released by Chinese Government, China is Sri Lanka's sixth largest export destination and second largest source of import. In 2015, Sino-Sri Lanka bilateral trade recorded a 11.3% yearly increase to 4.03 billion US dollars, and the imports from China accounted for 19.6% of Sri Lanka's overall imports. From January to September 2016, bilateral trade increased 5.8% to 3.08 billion US dollars, and the imports from China surpassed 20% of Sri Lanka's overall imports. Besides bilateral trade, Chinese investment and engineering contract projects also show fruitful results. Up to June 2016, cumulative Chinese direct investments in Sri Lanka amounted to 440 million US dollars, and the value of newly signed contract reached 16.5 billion US dollars.⁴² The two countries also endeavor towards a Free Trade Agreement (FTA), for which the fourth round negotiations was held in Beijing late November, 2016.

In fact, “development” is the time-tested key word to define Sino-Sri Lanka cooperation. The development strategies of China and Sri Lanka promise a great potential for convergence. On the one hand, both countries share the same goals of economic and social development,

41 “Joint Statement between the People's Republic of China and the Democratic Socialist Republic of Sri Lanka”, April 2016, <http://www.mfa.gov.lk/index.php/en/media/media-releases/6452-jointstatement-slpmvisitchina>. (Accessed on November 18, 2016)

42 “Sino-Sri Lanka Economic and Trade Cooperation”, September 6, 2016, <http://yzs.mofcom.gov.cn/article/t/201609/20160901384783.shtml>. (Accessed on November 18, 2016)

poverty alleviation, and improvement of peoples' well-being. Thus, when China launches the OBOR initiative and is willing to share development dividends with all countries alongside the OBOR, Sri Lanka will benefit by participation in it. Since Sri Lanka projects herself as having a huge potential to be a regional trade and transport hub, the country claims an important pivotal status in the Chinese OBOR, mainly in the MSR. If Sino-Sri Lanka bilateral cooperation failed, the Chinese MSR couldn't be termed as successful. On the other hand, though both countries are developing countries, they are at different stages of development and consequently enjoy some complementarities. For example, Sri Lanka faces the huge task of infrastructure building such as ports, roads, etc, while China has many competent enterprises with experience, technology and funds. Sri Lanka has the geographic advantage and the ambition to be a maritime hub, while the Chinese MSR aims to improve comprehensive interconnectivity.

Last but not the least, China and Sri Lanka enjoy friendly diplomatic relations. The two countries also have good people-to-people relations ensuring time-tested friendship. Ocean has always been a bridge for bilateral exchange and it's recorded that ZHENG He, Chinese pioneer in the ancient Maritime Silk Road, stayed in Sri Lanka five times out of his seven voyages. After the founding of the People's Republic of China, Sri Lanka was one of the earliest non-socialist countries to recognize China. The signing of the Rubber-Rice Pact in 1952 is the very example for bilateral cooperation. During the past few years, China and Sri Lanka witnessed relatively stable and good relationship. Particularly at the final stage of Sri Lanka government's fighting against LTTE, China gave strong economic, diplomatic and military support. Chinese support was welcomed at all walks of life within Sri Lanka. Another factor in Sino-Sri Lanka relationship is India. Due to the Tamil issue and India's foreign policy, Indo-Sri Lanka relationship witnessed the "control" and "counter-control" phenomenon. For many South Asian countries, India

is the regional dominant power incurring “reliance” and “resistance” at the same time. Thus, Sri Lanka needs to develop good relationship with extra-regional powers, such as China, to balance the Indian influence. Of course, the third party factor is one double-edged sword and the challenge perspective will be discussed later.

As to the challenges, one is strategic and the other tactical. The strategic challenge is the geostrategic concern from other powers, mainly the neighboring India. Considering the South Asian geostrategic reality, India tends to view the region as its “sphere of influence” and is extremely sensitive to extra-regional powers’ presence in this region. Because of the unsettled border dispute, India looks warily at China increasing presence and influence in this region, particularly in Pakistan, Nepal and Sri Lanka. That’s why the utterly baseless “Chinese string of pearls strategy” is widely accepted by Indian strategic community. Thus, India always shows alertness towards Sino-Sri Lanka cooperation, worrying that Sri Lanka would be one of the “pearls”. When Sri Lanka’s former President Mahinda Rajapaksa implemented comprehensive cooperation with China, India’s geostrategic concern became more serious. In the late 2014, when a Chinese conventional submarine paid a public visit to Colombo Port, India lost patience and former President Rajapaksa accused India of being the mastermind behind his unexpected presidential defeat.⁴³ Moreover, India is the only South Asian country that hasn’t shown political support to Chinese OBOR. Thus, when China and Sri Lanka continue to deepen their maritime cooperation under MSR,

43 John Chalmers and Sanjeev Miglani, “Indian Spy’s Role Alleged in Sri Lankan President’s Election Defeat”, January 17, 2015, <http://www.reuters.com/article/us-sri-lanka-election-india-insight-idUSKBN0KR03020150118>; “India’s Spy Agency RAW Behind My Poll Defeat, Says Former Sri Lankan President Mahinda Rajapaksa”, March 13, 2015, <http://indiatoday.intoday.in/story/sri-lanka-president-mahinda-rajapaksa-blames-india-raw-for-his-election-defeat/1/423763.html>. (Accessed on November 11, 2016)

India's reaction deserves special attention. That's why Chinese Foreign Minister WANG Yi once proposed China-India-Sri Lanka trilateral cooperation.⁴⁴

The tactical challenge is how to nurture a friendly environment for bilateral cooperation. Sri Lanka Government didn't adhere to a few cooperation projects ratified by the former Government, thus incurring Chinese concerns that bilateral cooperation would be affected by domestic political situation. Though the Sri Lanka government has already resumed the Colombo Port City Project recently, its policy to suspend some Chinese contracted projects under the excuse of environmental clearance raises serious concerns. China respects Sri Lanka's domestic political development and its independent foreign policy, but also requires its commitment to contracted projects. On the Chinese side, the Chinese Government didn't elaborate clearly the dynamic, logic and benefits of OBOR initiative to its Sri Lanka counterpart at the initial stage, leading to some misperceptions and misunderstandings. Moreover, some Chinese enterprises didn't care about the Corporate Social Responsibility (CSR). The MSR is one mega-project implemented mainly by business entities, and the behavior of these entities reflect MSR's public image.

Part III : The Way Forward

Based on the above discussion, we can conclude that both countries are important for the others' development strategies, and maritime arena offers huge potential for further cooperation.

44 "Wang Yi: China Stands Ready to Actively Discuss China-Sri Lanka-India Trilateral Cooperation", February 27, 2015, http://www.fmprc.gov.cn/mfa_eng/wjwb_663304/zzjg_663340/yzs_663350/gjlb_663354/2782_663558/2784_663562/t1241671.shtml. (Accessed on November 11, 2016)

Some recommendations are as follows:

(A). For both China and Sri Lanka

1. the two sides should make use of the year 2017, which is the 60th anniversary of the establishment of bilateral diplomatic relations and the 65th anniversary of the signing of Rubber-Rice Pact, to upgrade bilateral strategic trust;
2. the two sides should accelerate the work by the Joint Committee on Coastal and Marine Cooperation, which could be upgraded as the mechanism concentrating on fostering and monitoring the implementation of maritime cooperation under MSR;
3. the two sides could encourage the Indian counterpart to participate, so that India becomes one stake-holder in our cooperation;
4. the two sides should strengthen and broaden their maritime cooperation, such as joint exercises, humanitarian aid and rescue (HAR), law enforcement exchanges, joint personnel training, etc.

(B). For China

1. The Chinese Government should encourage competent enterprises to lead the maritime cooperation, and black - list those with poor CSR records;
2. The Chinese side should do more detailed research and analysis on Sri Lanka's development needs and avoid imposing its initiatives on Sri Lanka;
3. The Chinese side should invest more on poverty alleviation projects, such as fisheries technology transfer, etc.

(C). For Sri Lanka

1. Sri Lanka should reaffirm its respect and commitment to legal contracts, ensuring that these will not be affected by domestic political transition;
2. Sri Lanka should give priority list or 'early harvest' list for cooperation to the Chinese side, and give necessary assistance to Chinese counterparts for better understanding about its development needs.
