



FOREIGN AFFAIRS

China's Port to Nowhere

India Reins in Chinese Influence in Sri Lanka

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Sri Lanka's Galle Face Green, an iconic beach park in the capital of Colombo, has turned into a construction battleground as countries all over the world vie for influence over this gateway to the Indian Ocean. The Hong Kong-based Shangri-La and the Indian ITC hotel groups are poised to open their latest chains right next to each other. The American Hyatt and European Mövenpick are moving in just a mile down the road. The Chinese state-owned China Communications Construction Co. has financed a luxury playground at Colombo Port City that sports hotels, luxury apartments, a golf course, shopping malls, and a Formula One track. This project would have overshadowed all other developments in the park, but the city's newly elected government suspended construction in order **to**

review it for its economic viability, environmental risks, and potential infringement upon national sovereignty. Whether or not the project resumes, Western and Indian observers fear that China, with its billions of dollars invested in the Sri Lankan economy and infrastructure, may have already displaced competitors. Along with the intoxicating allure of Chinese money, the worry is that Sri Lanka—like the other developing nations of the Indian Ocean rim that form China’s “string of pearls”—will eventually yield to Beijing.

This argument, however, overestimates China’s leverage and disregards India’s influence over the region. Although China can coerce the countries of Southeast Asia to accept its demands by **threatening** to cut off trade, aid, investments, and other cash flows, those maneuvers will not work with Sri Lanka, because China’s economic investments there have been relatively shallow. India—owing to the depth of its economic, military, and social ties with Sri Lanka—still possesses greater influence over its island neighbor than China.

CHINA’S WHITE ELEPHANTS

When it comes to economic ties with Sri Lanka, China is more about quantity than quality. Beijing has dramatically increased financial assistance to Sri Lanka in recent years, but mostly in the form of loans, totaling between \$4 billion and \$5 billion since 2010. At present, direct grants, trade, and foreign direct investment remain limited. Further, Chinese investment loans are top-down. They are mostly designed to narrowly curry favor with the leadership, particularly with officials who served under the recently ousted President Mahinda Rajapaksa. These investments rarely generate downstream economic returns and thus breed tremendous resentment among the Sri Lankan public.

In even finer detail, most of the loans China offered were for “white elephants” masquerading as productive infrastructure investments. In other words, they are mostly vanity projects—a new cricket stadium, airport, and seaport (all built in Rajapaksa’s home district), as well as a new theater and a partially built communications tower in Colombo—that are **considered** frivolous, poorly planned, and debt generating. The Mattala Rajapaksa International Airport and the Magampura Mahinda Rajapaksa Port operate **significantly under capacity**. The express highways China funded are luxuriously wide and smooth but also see little traffic because the highway toll would cost the average Sri Lankan one-quarter of daily income. Former officials **have admitted** that the projects have failed to cater to the masses and receive no more than a fraction of the anticipated volume and revenue.

When it comes to China’s public infrastructure spending in Sri Lanka—although it purports to stimulate the economy—Beijing’s mode of investment has failed to trickle down to benefit local businesses, employment, or wages. Further, construction projects largely financed by China’s Export-Import Bank often come with a caveat: that contracts be awarded to Chinese state-owned companies, which then bring their own labor and raw materials. One **study**, by Wisconsin’s Robert M. La Follette School of Public Affairs, described these projects as more of a domestic stimulus for the Chinese economy.

In a sense, China’s investments are akin to predatory lending. They force Sri Lankans to borrow at high rates for projects that economically benefit the lender, China. At least that is how they are perceived by the Sri Lankans, triggering widespread resentment owing to cost overruns; high

(sometimes floating) interest rates of three to six percent (in comparison, the World Bank and the Asian Development Bank offer loans with fixed interest rates of 0.25 to three percent, and other governments such as Japan and Kuwait **lend** at 0.1 to 0.2 percent); undisclosed conditions such as exclusive usage rights; and the absence of competitive bidding, transparency, or accountability, which sometimes results in low-quality products.

For example, the Norochcholai coal power plant, finished in 2011, suffered **repeated and costly breakdowns (amounting to a quarter of its operational life)**. And it was built so that only Chinese engineers could repair it. The population, worried that China might be starting to use corruption and cronyism as sources of control over the country, was outraged. China has also been blamed for saddling Sri Lanka with unnecessary debt, saturating it with tens of thousands of Chinese workers, and treating the country as a “colony” and Sri Lankans as “slaves.” The mounting frustration and anger, which could not be expressed openly, eventually spilled over and precipitated a surprising **change of government** in the January 2015 elections. While China was not the sole cause of the turnover, it **failed to realize** that public resentment toward its colonial behavior and tacit support of corruption would usher in an opposition victory and jeopardize Beijing’s standing.

But strategists wary of Chinese expansion in the Indian Ocean needn’t be so worried about Beijing. Since China’s economic engagement with the country has been so thin, it has few coercive levers. Trade is indeed rising between the two countries, but 96 percent of their exchange is made up of exports from China to Sri Lanka (and that includes the raw materials and labor China brings from

home for its own construction projects). Chinese imports, tourists, and remittances to Sri Lanka are minuscule, so China's threats to punish Sri Lanka economically would not have much bite.

MADE IN TRADE

India has cultivated much deeper ties to Sri Lanka through investment, trade, remittances, direct aid, and loans that do have downstream impact. Since brokering the Indo–Sri Lanka Free Trade Agreement, India has significantly outpaced China as Sri Lanka's second-largest source of foreign direct investment, behind only Malaysia. India has invested a total of \$1 billion since 2003 and in 2013 committed \$2 billion over five years in vital sectors including transportation, telecommunications, health care, energy, banking, and tourism. Indian foreign direct investment facilitates crucial technology transfers, licensing, partnerships, trade creation, and human capital development, which are all coveted by developing countries for economic growth but which China has failed to provide.

Meanwhile, the free trade agreement has not only made India Sri Lanka's largest trading partner, it has also **disproportionately** benefited Sri Lanka by reducing trade imbalances. That is why Indian imports from Sri Lanka are **four times** China's. Even prior to formal trade agreements, economist **Muttukrishna Sarvananthan's** research had demonstrated that India had been a major partner for contraband trade, which entered the country sans tariffs on items ranging from spices to electronics to cars and at one point was **estimated** to be ten times official Sri Lankan exports.

Besides the Gulf region, India is the second-largest source of worker remittances, having **injected**

nearly \$1 billion into the Sri Lankan economy between 2010 and 2012 (almost 0.7 percent of GDP annually).

While China built highways and ports to nowhere, Indian assistance provided direct benefits to the Sri Lankan people. For example, India overhauled the rail networks, which serve **more than 300,000** daily commuters, and built 50,000 houses for people displaced by the civil war. Some mistakenly describe Chinese investments as “development aid” when, in fact, 98 percent of the assistance are loans. India has been **four times more generous** than China with direct grants and also entered into a \$1.5 billion currency swap in order to “keep the Sri Lankan rupee stable,” **according to** Prime Minister Narendra Modi. Sri Lanka clearly depends on India, not China, to catalyze its economic growth. At a recent conference, Finance Minister Ravi Karunanayake **expressed** the goal to see Sri Lanka become to India what Hong Kong is to China.

MORE THAN MONEY CAN BUY

Not only does India serve as one of Sri Lanka’s most important economic partners, it has also historically forged strong military ties, dating back to the end of British rule. For the first two decades after independence, Sri Lankan military officers **trained** in the Indian and Pakistan military academies, and in 1971, India helped Sri Lanka put down a countrywide rebellion. China has been lauded for providing offensive weapons, ammunition, and diplomatic support for Sri Lanka’s successful counterinsurgency operations against the militant group Liberation Tigers of Tamil Eelam, but officials credit India with playing a quieter albeit equally important role. Although India was

politically constrained from selling offensive weapons to Sri Lanka, it **facilitated** arms deals, sold defensive weapons, and provided critical naval and intelligence support to effectively help Sri Lanka target 'Tamil Tigers' positions and armaments.

The Indian military also currently enjoys a level of cooperation with Sri Lanka that China most likely never will. Joint military exercises and training, particularly between their navies, **resumed** by 2009 after a brief hiatus during the civil war. Between 2011 and 2013, almost 1,700 (roughly ten percent) of the officer corps **trained** at some point in India. Sri Lankan leaders also appreciate India's provision of rapid naval assistance during crises, such as after the 2004 tsunami, as well as the 100,000 troops for the Indian peacekeeping mission between 1987 and 1990. Meanwhile, China has not conducted joint exercises but has only sent (as have a number of other South Asian countries) a handful of **military observers** to a Sri Lankan field training. Foreign Minister Mangala Samaraweera also recently made it clear that Chinese submarines would no longer be welcome to dock at their harbors.

Social similarities further connect Sri Lanka and India in ways that China cannot. Take, for example, their shared cultural influences, such as Bollywood, and a common liberal democratic political system. When it comes to tourism, Indians make up 20 percent of Sri Lanka's visitors, compared with China's rather meager 3 percent. In return, over a quarter million Sri Lankan tourists flock to India for the holidays. Sri Lankans also recognize that India can leverage its ethnic ties to the island's Tamil minority to make trouble for the government, as it did during the 1980s.

Many attribute Sri Lanka's recent **diplomatic overtures** toward India (by giving it diplomatic priority over other countries) to a change in government and **active Indian diplomacy**, but this view underestimates what was part of a natural, and perhaps inevitable, growth toward closer relations with India. The former administration under Rajapaksa indeed shifted rhetorically toward China, but it may have done so out of selfish interest rather than as a strategically significant maneuver, because, as some Sri Lankan political economists expressed, it "defied national economic logic." Even if the Colombo Port City project resumes and new Chinese infrastructure loans come flowing in, Sri Lanka will not jeopardize its relationship with its closest neighbor, India. Those wary of China's creeping influence in the Indian Ocean should be reassured that a rising power such as India will naturally flex its own budding economic muscle to defend its Indian Ocean "neighborhood."

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