

Sri Lanka's Asia-Centric Focus in a Contested Bay of Bengal Region

By Dushni Weekaroon and Kithmina Hewage

The Bay of Bengal – home to one of the world's pre-eminent historic trading networks – is once again at the nexus of rising regional and global rivalries. A multiplicity of port developments along the Bay of Bengal littoral underscore the tussle for control of maritime connectivity and trade—as well as diplomatic and defense advantage. Against the backdrop of a weakened post COVID-19 global economy, and as countries seek every possible advantage, the probability of competing tensions spilling over into outright confrontations and tit-for-tat retaliatory measures is high.

Unless carefully assessed and managed, small but strategically positioned countries like Sri Lanka can get swept up and carried away in power rivalries being played out on their shores. Indeed, a common narrative has been to assert that Sri Lanka was forced to cede an important port to China after being lured into a 'debt trap' by easy Chinese loans. There is no gainsaying that over the last decade, China got a head start in investing in Sri Lanka's infrastructure push, drawing the country firmly into the orbit of its ambitious Belt and Road Initiative (BRI). Aside from China's famed involvement in Sri Lanka's Hambantota port, its long-term footprint is also assured through investments in a large-scale land reclamation project – the Colombo Port City – that is a vital link in its BRI chain of connectivity.

India's pushback against these developments helped bring about a change of government in Sri Lanka in 2015. Perceived to be pro-Western and pluralistic, the new government received generous backing not only from India, but from the United States and its allies. While key Chinese projects suffered setbacks, Sri Lanka inked an agreement allowing India and Japan to develop the strategically-located Colombo port's East Container Terminal (ECT). A U.S. offer of grant funding under the Millennium Challenge Corporation (MCC) to improve road connectivity and land tradability was also accepted.

But, in another sharp swing of public opinion, Sri Lanka's November 2019 presidential and August 2020 parliamentary elections saw the incumbent administration swept away on a resurgent tide of nationalist populism. The return of the formidable Rajapaksa political dynasty raises important questions about the country's future strategic, economic and political alignments just as the global economy and international power relations are being reset in fundamental ways.

At first glance, it appears that the odds are stacked overwhelmingly in favor of China, to bind Sri Lanka firmly to the BRI connectivity route in the Bay of Bengal. This supposition is strengthened by several policy reversals that have gone against its rivals, in keeping with the government's election promises to halt the 'sale of strategic assets' to foreign interests. The latter include putting on hold India's ETC deal, a Japanese funded light rail project, and the U.S. MCC grant offer. The Sri Lankan government has cited concerns about taking on additional foreign currency loans, as well as harmful impacts on the country's sovereignty and national interest as part of its review process of such international agreements.

Dushni Weekaroon and Kithmina Hewage, Executive Director and Research Economist, respectively, at the Institute of Policy Studies of Sri Lanka, explain that “Unless carefully assessed and managed, small but strategically positioned countries like Sri Lanka can get swept up and carried away in power rivalries being played out on their shores.”

Sri Lanka's alignments, however, will not be so clear cut for several reasons. First, the ruling government will be aware of past 'mistakes' in balancing relations with its neighboring giants. Indeed, Sri Lanka's newly elected president's first visit was to New Delhi with assurances of frank discussions to avoid misunderstandings and, more recently, a reiteration of an 'India First' strategic and security policy. India's goodwill is vital; historically, international pressure on Sri Lanka – be it on human rights or domestic power devolution – has been dealt with effectively only with India's tacit approval.

Second, Sri Lanka's embattled economy, especially in the wake of COVID-19, demands a carefully calibrated relationship with its powerful neighbors. As a highly indebted economy – with public debt at 90% of GDP and approximately half of it denominated in foreign currency – Sri Lanka is looking to India and China – two of the country's largest creditors – for debt relief. India accounts for 13.5% of Sri Lanka's total bilateral debt and China for another 12.2%. If the EXIM Bank of China loans are added, the latter's share of bilateral debt rises sharply to 54.3%. Of total debt though, China's share is still a relatively low 9.6% and debunks the view of Sri Lanka being caught up in debt-trap diplomacy spurred by China.

Both China and India so far have responded positively, albeit to provide hard currency – China with a \$500 million loan top up and India's \$400 million swap arrangement. A Sri Lankan request to India for an additional \$1.1 billion is pending.

Sri Lanka will also look to both China and India for foreign direct investment (FDI). Of the total stock of FDI in the country, China holds the pre-eminent position (16.7%), followed by India (12.9%). In trade export market share, India leads (6.4%) with China well behind (2%). In total though, it is clear that both countries are vital to Sri Lanka's long-term economic interests; the advantages to be had from closer integration with them as a source of new markets, development finance, FDI, and technology transfer is obvious. Thus, recent policy pronouncements that Sri Lanka's foreign policy will be Asia-centric makes good sense.

Balancing Sri Lanka's India and China interests while seeking engagement with a wider spectrum of economic opportunities in Asia will require deft political and diplomatic skills. Not only have tensions risen between India and China on border conflicts, but India has also pulled out of the China-dominant Regional Comprehensive Economic Partnership (RCEP) trade agreement.

For Sri Lanka, with a functioning bilateral trade pact with India already in place, a steady integration process with Southeast Asian countries along the Bay of Bengal and beyond with an eye on RCEP membership in the longer run seems the most beneficial 'Asia-centric' road map. To get there, the country needs to tread cautiously and insulate itself from aligning in favor of one major regional power over another. The starting point is to put its economic house in order, and decreased dependence on foreign loans and FDI for its strategic investments in infrastructure connectivity. This is all the more important in a post COVID-19 era as its consequent global political and economic disruptions and fast shifting power dynamics place small states in greater danger of being swept up in big power rivalries and the need to be able to depend in good part on themselves.

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