



Parahyangan Catholic University

Faculty of Social and Political Sciences

Department of International Relations

Terakreditasi Unggul

SK BAN-PT No. 2579/SK/BAN-PT/AK-ISK/S/IV/2022

Default From the Perspective of Victim: The Case of Sri Lanka's Hambantota Port

Undergraduate Thesis

By
Cheryl Jemima Faustine
6091901067

Bandung
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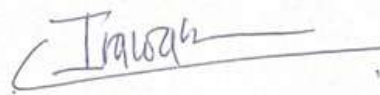
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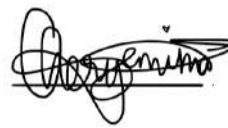
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Cheryl Jemima Faustine

ABSTRACT

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The IMF and World Bank emphasize that countries seeking external loans should conduct detailed assessments of their ability to repay these loans. The case of Hambantota Port in Sri Lanka highlights a lack of such assessments before securing loans from China, leading to the country defaulting in 2017. The Responsible Sovereign Lending and Borrowing Concept by Buccheti and Gulati is used to analyze this issue, focusing on realistic assessment, honesty, inheritance to future generations, and pre-disbursement diligence. The absence of a realistic assessment is evident in Sri Lanka's debt-to-GDP ratio preceding the loan agreement in 2007, indicating a lack of consideration for repayment capabilities. Transparency issues arose, revealing corruption and violations in economic activities, especially concerning the Hambantota Port Project. Despite defaulting, Sri Lanka still grapples with economic challenges and debt repayment struggles, burdening future generations. Concerning pre-disbursement diligence, the project exacerbated environmental and human rights impacts. Thousands were evicted, habitats like Sri Lanka's lagoon were harmed, and rare wildlife suffered due to the port's construction. This reflects irresponsible lending and borrowing practices. In close, the Hambantota Port loans lacked critical assessments, transparency, consideration for future generations, and due diligence.

Keywords: Sri Lanka's Chinese loan default, Hambantota Port, Responsible Sovereign Lending and Borrowing

ABSTRAK

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Pelabuhan Hambantota di Sri Lanka

IMF dan *World Bank* menekankan bahwa negara-negara yang mencari pinjaman luar negeri harus melakukan penilaian rinci terhadap kemampuan mereka membayar kembali pinjaman tersebut. Kasus Pelabuhan Hambantota di Sri Lanka menyoroti kurangnya penilaian sebelum mendapatkan pinjaman dari Tiongkok, yang menyebabkan negara tersebut mengalami *default* pada tahun 2017. Konsep *Responsible Sovereign Lending and Borrowing Concept* oleh Buccheta dan Gulati digunakan untuk menganalisis masalah ini, dengan fokus pada penilaian yang *realistic assessment, honesty, inheritance to future generations, and pre-disbursement diligence*. Tidak adanya *realistic assessment* terlihat pada rasio *debt-to-GDP* Sri Lanka sebelum perjanjian pinjaman pada tahun 2007, yang menunjukkan kurangnya pertimbangan terhadap kemampuan pembayaran kembali. Muncul isu transparansi yang mengungkap korupsi dan pelanggaran dalam kegiatan ekonomi, khususnya terkait Proyek Pelabuhan Hambantota. Meskipun gagal bayar, Sri Lanka masih bergulat dengan tantangan ekonomi dan kesulitan membayar hutang, sehingga membebani generasi mendatang. Terkait dengan *pre-disbursement diligence*, proyek ini memperburuk dampak lingkungan dan hak asasi manusia. Ribuan orang terusir, habitat seperti laguna Sri Lanka dirusak, dan satwa liar langka menderita akibat pembangunan pelabuhan merupakan dampak kerugian dari pembangunan proyek pelabuhan Hambantota. Hal ini mencerminkan praktik pinjam meminjam yang tidak bertanggung jawab. Singkatnya, pinjaman Pelabuhan Hambantota tidak memiliki *realistic assessment, honesty, inheritance to future generations, and pre-disbursement diligence*.

Kata kunci: Kegagalan Bayar Pinjaman Sri Lanka dari China, Pelabuhan Hambantota, *Responsible Sovereign Lending and Borrowing*

PREFACE

All praises to God Almighty for His never ending grace, guidance, and blessings that equipped the author throughout the whole thesis to complete it well. This thesis, titled “Default From the Perspective of Victim: A Case of Sri Lanka’s Hambantota Port” was prepared as a prerequisite for fulfilling the Bachelor of International Relations Study Program, Faculty of Social and Political Sciences, Parahyangan Catholic University, Bandung, Indonesia.

The topic the author chose for this thesis is based on the author’s interest in researching further issues related to international politics as well as security issues in the modern world. The author hopes that the usefulness of this research is beyond just discussing the case in the Hambantota Port but can also be a reference for many other cases, answering developing countries struggles stuck in loan default phenomenon and what is considered to be a responsible way of borrowing.

This research is well realized by the author that it is far from perfect and flawed. Therefore, the author apologizes for all shortcomings and errors that took place. All forms of correction, criticism, and suggestions are highly expected and will be accepted openly to improve this thesis.

Bandung, 21 Desember 2023



Cheryl Jemima Faustine

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Thank you to my fellow Parahyangan Catholic University friends, Jovan Effendi and Clivent Isakh. Thank you Jovan and Clivent for being such a great friend throughout the whole university journey and helping the author to have a great time. Also, to the author's Cahaya Bangsa childhood friends Enrico Abner Johan, Vernico Filbert Nathaniel. Thank you for the endless love and kindness as the years stretch. Thank you for the support along the way, the author will forever cherish the friendship that blooms and the journeys that prevailed.

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Not to forget the author wants to express her gratitude to her fellow thesis mates; Adithya, Nada, and Marcel who have been with her every step of the way, relentlessly fighting and prevailing to the end. We made it! The author is so proud of all of you and how far we have come. Cheers to the many more journeys we will unravel and face after this one. Congratulations once again, I'll see you on top!

Last but not least, the author would like to thank CJF for never stopping to try in the midst of struggling through the storms of life, love, and thesis. Very proud of you for finally reaching this point in hopes to always make your parents proud and blessed. Thank you for prevailing and choosing to keep fighting no matter the circumstances life throws at you. The author is very proud of the woman you are becoming. Congratulations!

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LIST OF ACRONYMS

CMPHCL: China Merchants Port Holdings Company Limited

GDP: Gross Domestic Product

IMF: International Monetary Fund

MR: Mahinda Rajapaksa

TEU: Twenty-foot Equivalent Unit

USD: United States Dollar

CHAPTER I

INTRODUCTION

1.1 Problem Background

The World Bank is an international organization in which it is owned by 187 nations. Its functions are to alleviate poverty by providing financial assistance to less affluent member governments, fostering economic improvement and enhancing the quality of life for their citizens. The institution provides loans to middle-income nations at interest rates that are below those offered by commercial banks. Loans and lending systemic according to the World Bank, when assessing for loans, the bank's personnel will meticulously examine the project, considering factors such as its potential economic contribution to the country, its impact on aiding the most impoverished communities. They also assess its environmental effects both presently and in the long term. The bank explores the feasibility of securing additional funding and evaluates the country's capability to sustain the project after the funding concludes.¹

Another global financial organization that is dedicated to fostering worldwide economic stability and advancement is the International Monetary Fund (IMF). The IMF offers financial aid, specialized knowledge to member nations encountering economic difficulties and supporting countries that deal with their balance of payments issues. IMF is redefining its priorities in economic surveillance,

¹ World Bank, "Getting to Know the World Bank," World Bank, July 26, 2012, https://www.worldbank.org/en/news/feature/2012/07/26/getting_to_know_theworldbank.

emphasizing more thoroughly on risk analysis, they prioritize challenges in global and national economic stability. Their assessments currently focus more on expected outcomes, neglecting potential risks that could jeopardize economic stability. They systematically evaluate risks, including significant potential impacts on tail risks.²

Reviewing the international standard of loans and lending according to the World Bank and IMF, it is clear that when a country decides to take out a loan from another country or institution of the sort, one of the most fundamental conditions is that the country in which that takes the loans has to have the ability to repay the loans.³ Both the IMF and World Bank also focus a lot on examining the country's ability to repay the funds needed to support the project and also the funds needed after the project is completed, also, it emphasizes a lot on reducing risks to the country's economy.⁴

The international standards given by the IMF and World Bank, it can be seen that when a country does not follow the standards for loans, borrowing, and lendings given, it can create problems especially for the country that borrows. This leads to the case study that the author uses for this research paper which is the default that happens in Sri Lanka's Hambantota Port.

1.2 Problem Identification

Sri Lanka was looking to expand their infrastructure and ports, hence the country looked for loans to borrow in order to make their plans in motion. Sri Lanka

² Piyabha Kongsamut and IMF Strategy, Policy, and Review Department, "IMF Survey: IMF to Sharpen Assessment of Risks Facing Countries," IMF, October 13, 2008, <https://www.imf.org/en/News/Articles/2015/09/28/04/53/sopol101308a>.

³ World Bank, "Getting to Know the World Bank," World Bank, July 26, 2012,

https://www.worldbank.org/en/news/feature/2012/07/26/getting_to_know_theworldbank.

⁴ Loc. cit.

wasn't in a feasible position to take out a loan but they decided to take out the loans that were given by China instead. China accepts their loan proposal and decides to give Sri Lanka the loans to proceed with building the Hambantota Port. In the year 2007, Sri Lanka and China signed a contract agreement that marked the start of their cooperation in the Hambantota Port construction. Problems surged as Sri Lanka still decided to take the Chinese loans despite the country's questionable feasibility in repaying the debt loans and it created controversies towards the act.⁵

The international standard of loans according to two of the biggest institutions discussed above, clearly states that with Sri Lanka's dubious ability in repaying the loans, the country should have considered it more thoroughly. According to the standards, Sri Lanka should have also done a more meticulous assessment towards their capability of repaying the loans by inspecting the country's debt-to-GDP ratio to look more closely at the country's capability. With that being said, in this case, the problem identification of this research paper lies within Sri Lanka's decision on taking the loans even with the country's questionable ability to repay the debt in the long term. Sri Lanka still decides to take the loans and borrow from China instead which stirs many turmoil that will be further elaborated and discussed in this research.

1.2.1 Scope of Research

The scope of research in this paper is focused on the case study of Sri Lanka's Hambantota Port with the Chinese loans that funds the construction of the

⁵ Anjelina Patrick, "China - Sri Lanka Strategic Hambantota Port Deal," China - Sri Lanka Strategic Hambantota Port Deal, April 13, 2017, 1, <https://maritimeindia.org/8813-2/>.

port itself. With the loans that were taken by Sri Lanka, there are several problems that arise, in accordance with the country's failure on following the international loan standards precisely, hence the default that was done by the country itself. The author then limits the research from 2007, the beginning of Sri Lanka and China's agreement of the loan investments to the country's condition in 2017 (when the port's 99-year-lease agreement between Sri Lanka and China was signed, which marks the handover of 80% of the port to China) along with its impacts in the years after their default. The main focus of this paper is to further look into Sri Lanka's decision to borrow from China still, even with their unfeasible ability to repay them which caused their default in the latter years. Then to carry out the analysis in this study, the author uses the Responsible Sovereign Lending and Borrowing Concept as the theoretical framework.

1.2.2 Research Question

According to the problem background, problem identification, and scope of research with which has been mentioned and discussed above, the author has come to the main question of this whole research paper that is focused on questioning, **“What are the factors of Sri Lanka's unfeasible loans from the Chinese government?”**

1.3 Objective and Usage of Research

1.3.1 Research Purpose

This research paper aims to analyze more on the right conditions and process of borrowing that can be seen through Sri Lanka's decision to still borrow and take the loans given by China for the construction of the Hambantota Port even with the state's dubious ability in repaying the debts. This created problems especially for Sri Lanka in many aspects as a country which led to their decision of defaulting from the loan deals. This research will look further into the international standard and responsible way of taking and giving loans and put into equation the case of the Hambantota Port with the Chinese loans and Sri Lanka's decision in place.

1.3.2 Research Usage

This research paper is useful for increasing the understanding of how a proper and responsible loan should have taken place. Sri Lanka wasn't in a feasible state to repay the debt from the loans given but the country still decided to take the Chinese loans instead, which led to a default and turned out to be the cause of the country's many problems in a lot of aspects. Hence this paper will be much of a use for studying the right conditions on how a country should have been in to be feasible in repaying the loans that it took. Furthermore, the author hopes that this research may provide a more in depth understanding of the concepts and theories used as the fundamental basis of the research so that it may be of a consideration for the readers to use this research as a useful reference. Also, in hopes to widen the reader's

knowledge through the theoretical framework that is used to further explain the author's perspective towards this case study in this research paper.

1.4 Literature Review

The author will be attaching several books or journals that are used to help explain and provide a more in depth understanding of this research regarding how a proper loan should have been conducted through the loans of Sri Lanka's Hambantota Port. The literature review or reference that will be used are as follows.

The first journal that is titled **Chinese Investment and the BRI in Sri Lanka** is written by Ganeshan Wignaraja, Dinusha Panditaratne, Pabasara Kannangara and Divya Hundlani. This journal's main focus is revolving around the overall advantages and drawbacks of the Belt and Road Initiative (BRI) and its ventures in Sri Lanka, aiming to extract lessons that could enhance future BRI endeavors not only in Sri Lanka but also in other locations. Criticisms encompass concerns about falling into a 'debt trap', displacing local workers, causing environmental harm, and posing security risks associated with Chinese investments but the journal states that there is an absence in the policy research of the 'debt trap' claim because the author of this journal believes and tries to prove that this is not just a negative impact caused by the Chinese investments but also a valuable lesson that other developing countries can take into account if they were to do cooperation with

China in the future.⁶ The gap between the journal and this research paper lies between the journal's focus in proving that the impacts which springs from the Chinese investments are not always negative as there are lessons that we can learn from but the author of this research paper believes otherwise and tries to prove that once again, with Sri Lanka's unfeasible position to borrow and repay the loans, the negative impacts that occurs are not worth a lesson for other developing countries but it has become far worse, which is the country's downfall and its failing economy of the country.

The second journal article is titled **China - Sri Lanka Strategic Hambantota Port Deal** and is written by Anjelina Patrick. This journal analyzes and explores the Hambantota Port project's progression amid Sri Lanka's economic decline, delving into its impact on security, politics, and society, while examining China's motivations behind this substantial yet unsustainable investment. The journal discussion revolves around the timeline and framework of the Hambantota's Project from its first initial signing of the loan towards the construction. It also brings into discussion a few of the implications that the projects have caused both internally and externally towards Sri Lanka.⁷ The gap lies within its approach in solely analyzing China's motivation or perspective in lending the loans hence the discussion's focus in this research paper which focuses on Sri Lanka's perspective on their decision of taking the loans still even with their improper position and questionable ability in repaying the loans that led to their default.

⁶ Ganeshan Wignaraja et al., "Chinese Investment and the BRI in Sri Lanka," Chinese Investment and the BRI in Sri Lanka, no. ISBN: 978 1 78413 384 9 (March 18, 2020): Pg. 2-3, <https://www.chathamhouse.org/2020/03/chinese-investment-and-bri-sri-lanka>.

⁷ Anjelina Patrick, "China - Sri Lanka Strategic Hambantota Port Deal," China - Sri Lanka Strategic Hambantota Port Deal, April 13, 2017, Pg. 1, <https://maritimeindia.org/8813-2/>.

The third and last journal article that is used to further help explain this research is titled **The Myth of ‘Debt-Trap Diplomacy’ and Realities of Chinese Development Finance** that is written by Ajit Singh. This article examines other investments that China made outside of Sri Lanka in order to show that Chinese loans are bringing good impact and not the main cause of the countries’ debts. This journal article has given good insights into China's other loan investments in order to prove that the country is not performing any traps with their loans. The journal focuses solely on the Chinese loans and its well driven impacts towards the countries it gave loans to.⁸ The gap lies in the journal’s focus on the good impacts that the Chinese investments brought towards the borrowing countries. What differentiates this research paper from the journal lies within the discussion of negative causes that the loans have impacted towards Sri Lanka. It also lies in the perspective that is put in use in which this journal uses China’s perspective and approach whilst this research uses and focuses on Sri Lanka’s perspective towards the issue in the Hambantota Port.

Of the three literature reviews used, the author found several “gaps” or that ultimately made the author’s focus on discussing these gaps in the research. Problems that have not been addressed from the three literature reviews are solely the negative impacts that the loans brought to Sri Lanka from the country’s perspective with their infeasibility of repaying in the first place. Continuing, in contrast to the last literature review, the third article challenges the idea of 'debt-trap diplomacy' by showcasing positive impacts of Chinese loans elsewhere, diverging

⁸ Ajit Singh (2021) The myth of ‘debt-trap diplomacy’ and realities of Chinese development finance, *Third World Quarterly*, 42:2, 239-253, DOI: 10.1080/01436597.2020.1807318

from the focus on the negative effects of Chinese loans specifically in Sri Lanka's Hambantota Port in the other two journals whilst in this research the author emphasize the discussion on the loans taken by Sri Lanka even with its questionable ability in repaying the loans that led to their default and the impacts that surfaced.

1.5 Theoretical Framework

In this research, the theoretical framework that will be used to further explain the research is the Responsible Sovereign Lending and Borrowing Concept by Lee C. Buchheit and G. Mitu Gulati. This theory becomes the fundamental base of this research in addressing the loans taken by Sri Lanka even with its questionable ability on repaying it back so that it may help create a more structured and well systematic dissertation and analysis by the author.

In short, this theoretical framework discusses and explains how the Responsible Sovereign Lending and Borrowing Concept comes in handy when understanding the responsibilities between sovereign borrowers and lenders which is crucial for several main reasons. Thus, in order to prevent and fulfill all of the obligations and conditions mentioned above, the author will further elaborate on the requirements on how responsible sovereign lending and borrowing should have taken place through this theoretical framework concept used.

The first variable is the realistic assessment aspect that states in a profit-driven sovereign loan, it is highly recommended that it will be assessed very carefully especially if the lender is seeking a greater amount of returned value than

what is lent. This assessment will be used to foresee if the borrower party is feasible and is in a position in paying back the loans given. Loans that are done from one government to another's aim might revolve around the objectives outside of other than just financial gain, but also in amplifying the lender's geopolitical influence as well as acquiring natural resources. In these kinds of situations, these other causes outside of just the financial gain that the lender would get, it would encourage and be the reason that a real, meticulous, and well detailed assessment of the borrower's repayment capability would not have taken place. It just so happens that usually the loans will surely be approved not solely because of the borrower's feasibility and ability to repay the loans but rather, the approval would be based on these alternative gains for their aims in the first place.⁹

The second variable that will be used by the author is honesty or can also be seen as transparency of both parties but mostly on the borrowing country in order to prevent unwanted things from happening such as internal conflicts or worse, corruption. This variable states that lenders should not encourage or ignore the facts towards actions that are considered against the ethical duty or obligations of the borrowing country's government officials in the borrowing act. The control of law enforcement and the legal system in a country or in this case, the borrowing country, are under the government's control which at times makes it harder to detect whenever a corruption takes place and deals with it. However the situation or conditions of the borrower's country, the lender's responsibility stays the same. Confidentiality and secrecy in times where deals like these are transpiring might just

⁹ Lee C. Buchheit and G. Mitu Gulati, "Responsible Sovereign Lending and Borrowing," *Law and Contemporary Problems* 73, no. 4 (2010): 63–92, <https://www.jstor.org/stable/25800670>.

foster and stimulate just the right atmosphere where corruption may flourish and develop.¹⁰

The third variable is old sins cast long shadows or in other words the inheritance of the next generation that states how the sovereign debt a nation accumulates becomes part of the legacy passed down to the next generation, much like the nation's history of managing the debt. When actors from the borrowing country preferably choose short-term popularity by means of prioritizing the plans that will only make the country greater but ignoring easily repayable debts, it might as well be passed on to the next future generations and differently. This whole act might result in many negative outcomes such as restrictions in borrowing opportunities or an increase in the interest rates in the market due to the decisions of those politically made. The consequence is unthinkable but a country who is perceived as one that is responsible in navigating such challenges financially, might pass on the benefits and make it of use to its future generations.¹¹

The fourth and the last variable is Pre-Disbursement Diligence which discusses a lot about the impact towards the environment and indigenous people. This variable states a careful evaluation of how the use of the loan funds should be in line with the lender's interests. Foregoing in the funds release, the lender's in-depth examination suggests two main elements which are the commercial and legal elements. In the commercial side, the borrower's overall capability is assessed in order to determine whether the country could repay the loan debts as well as using the funds for a specific purpose. Moreover, lenders usually have policies that pertain

¹⁰ Ibid, pg. 76.

¹¹ Ibid, pg. 81.

to the environmental impact of the project as well as the human rights record from the borrower's party. On the legal side, it mainly discusses authorization of loans which includes everything that focuses on the contracts and obligations that may or may not lead to a rule breaking from the borrower.¹²

1.6 Research Method and Data Collecting Technique

1.6.1 Research Method

The research method that will be used is the qualitative method. All forms of research and data collection were carried out based on the internet and documents because in this research the author is trying to analyze the loans that Sri Lanka decided to take or borrow from China in the Hambantota Port. The qualitative method itself focuses on the correlation between two interactive variables. By understanding that two variables have a causal correlation that is interconnected so that at the end of the research, the author can find a new pattern or meaning that provides another point of view regarding the issue that is analyzed.

Furthermore, the qualitative method that this author uses will focus on secondary data in the form of journals, books and other tools such as the internet. The research and issues raised will be presented intuitively and systematically in order to produce coherent and efficient knowledge. Thus, these data will be used to investigate a phenomenon from the issues raised so that researchers can develop a new understanding of how a proper loan should have been conducted from the loans in Sri Lanka's Hambantota Port.

¹² Ibid, pg. 77.

1.6.2 Data Gathering Technique

The techniques of data collecting in this research are obtained from various sources such as books, literature journals, as well as documentations of the case (videos, photos, and audio recordings) that can be accessed through the internet of which totally are correspondent to the Responsible Sovereign Lending and Borrowing Concept whilst this particular research focuses on the Hambantota Port case study. The author will also be open to other supporting data, sources, and information that may be of help for the continuation of the research. The method that will be used for this research will be an assemblance of data and information that the author obtained and piece together in a well thought order to form this research paper.

1.7. Thesis Structure

The author will be dividing this research into four chapters in the following order. The following is the systematic division of the topics discussed:

Chapter I contains the background information to the problem as well as the problem identification which includes the scope of research and formulation of the problem. Furthermore, the purpose and usage of this research are also attached. Continuing, the author also includes explanation to the literature review and theoretical framework that forms the basis of the research and plays an important role in assisting the flow of the analysis that is conducted by the author in this

research paper. In the last section of the chapter, there lies the research methods and techniques of the data collection enclosed with the systematic order of the discussion.

Chapter II of this research paper contains a continuation of the first chapter that is titled Sri Lanka's Start to Downturn: The Hambantota Port Project, where the author focuses on explaining more thoroughly regarding the international standard of loans and how it will be useful to analyze the case study of the port. It further elaborates on the history of Sri Lanka and China's relations over the years up to the point of the loan agreement along with the development of the port itself. The Hambantota port development cooperation will be explained in depth and detail to help provide a more thorough understanding of how the investment in this project affected Sri Lanka. This chapter will be closed with an intricate discussion regarding Sri Lanka's situation before and after the loans. Not to mention the economic development throughout the years that shows the infeasibility of Sri Lanka in repaying their debts which ends up having to sign the 99-year-lease agreement in order to fulfill the remaining amount of debt it has to the Chinese government from which it can be seen the serious impact it brings towards Sri Lanka in several aspects. This explanation will then become a bridge and the introduction for the next chapter, that is Chapter III.

This next chapter, Chapter III, is titled Analysis of the Hambantota Port Project Based on the Responsible Sovereign Lending and Borrowing Concept in which it contains answers to the following research questions based on the theory that is used. Moreover, the author will analyze deeper of the Hambantota Port

Project case study in accord with the research question as well as the existing theoretical framework. The author will be applying the theoretical framework in order to elaborate more on analyzing the case study, explaining about Sri Lanka's decision on taking the loans that lead to a default that takes place in 2017 (the 80% handover of the port under the Chinese government) and the impacts that the country still struggled for years onward.

Closing with the last chapter, Chapter IV is where the author will be concluding all the research's results that have been explained and or summarize from the previous three chapters discussed above.