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The Hambantota Port Deal: Myths and Realities

Untangling the truth about Chinese debt and Sri Lanka means cutting through some misleading media narratives.

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In an interesting turn of events, newly elected Sri Lankan President Gotabhaya Rajapaksa has raised concerns about the Hambantota port lease agreement with China, signed in 2017 by the previous government. During his very first interview as the newly elected president, Rajapaksa said that he will revisit the Hambantota port lease agreement and renegotiate it.

However, during a meeting with foreign correspondents based on Colombo, Rajapaksa clarified that his government is not hoping to amend the commercial terms of the agreement and is only looking at potential changes regarding the security of the port.

The Chinese government soon welcomed the statement from the Sri Lankan president. Issuing a statement, the Chinese embassy stressed that they respect the sovereignty of Sri Lanka and that the security of the port is in the hands of the Sri Lankan government and navy.

The comments made by Rajapaksa piqued the interest of many as the Hambantota port deal is still widely cited to highlight China's "debt trap" phenomenon. However, there are a lot of myths pertaining to this port deal, most of which have received little or no clarification.

For starters, the Hambantota port deal cannot be interpreted as a debt-equity swap or the Chinese cancelling debt in exchange for control of the port — although that seems to be a well-established narrative. The Sri Lankan government is still obliged to pay off five loans obtained from the Exim Bank of China to construct the Hambantota port and the agreements pertaining to those loans have not been amended. The loans were not defaulted and the loan agreements remain unchanged.

In that sense, the port lease cannot be interpreted as a debt-equity swap, which refers to a cancellation of debt in exchange for the equity of an asset. In this case there was no cancellation of the debt.

Instead, a 70 percent stake of the port was leased to China Merchants Port Holdings Company Limited (CM Port) for 99 years for $1.12 billion. This $1.12 billion, however, was not used to pay off the debt obtained to construct the port. This significant dollar inflow was used to strengthen the country's foreign reserves and make some short-term foreign debt repayments. To be precise, it is fair to say that the money earned from the Hambantota port deal was largely used to cover balance of payment (BOP) issues resulting largely from the soaring debt servicing cost while Sri Lanka's export and FDI inflow growth remain sluggish.

In August 2017, Sri Lanka's cabinet of ministers took a decision to sign a concession agreement with CM Port to operate the Hambantota Port as a Private Public Partnership (PPP) project under which a 70 percent stake of the port is leased to CM Port. The remaining 30 percent of the stake is owned by the Sri Lanka Ports Authority (SLPA) and the commercial operations of the port are handled by the CM Port and the SLPA jointly while the government of Sri Lanka still owns the port. At the time of entering into the lease agreement, Hambantota Port was valued at $1.4 billion and CM Port invested $1.12 billion as per the terms of the agreement.

A common and popular myth is that Sri Lanka was unable to pay off the loan obtained to construct the port, thus it was handed over to China. However, by the time the Sri Lankan government entered into the agreement with CM Port to lease Hambantota port, the debt servicing cost pertaining to the loans obtained from China Exim bank to construct the port did not amount to much. Those loan installments (including interest) amounted to less than 5 percent of Sri Lanka's total foreign debt repayments. Furthermore, loan repayments pertaining to the second phase of the Hambantota port project were yet to start at the time. A more serious concern pertaining to foreign debt servicing cost was the maturity of sovereign bonds, which amounted to more than 40 percent of the total debt servicing payments in 2019.

There were five loans (excluding loans obtained for a bunkering facility project) obtained from 2007 to 2014 to construct the port under the government led by Mahinda Rajapaksa, who now holds the office of prime minister. Some of the loans were obtained at interest rates as high as 6 percent while some were concessionary loans. The total sum of these loans amounted to $1.263 billion. Out of these five loans, just two loans, collectively worth $357 million, were obtained at commercial rates, indicating that the majority of the loans for the Hambantota port project were concessionary. However, the loan payback period was not long, which resulted in higher loan installments subsequent to the completion of the grace period.

In that context, it is incorrect to claim that China acquired Hambantota port because Sri Lanka failed to pay off the debt obtained to construct the port. The often quoted "port deal" was actually a lease agreement clearly separate from the loans obtained for the purpose of constructing the port and the money obtained from the lease was used to strengthen the foreign reserves of the country, not to repay China. There was no cancellation of debt, although the port was leased to China for 99 years. There has been no change in ownership. However, as per the lease agreement, a significant portion of the operations in the port will be handled by China Merchant Port company, thus a large portion of the profit, if any, will be earned by CM Port.

Leasing out Hambantota port is not evidence of the Chinese debt trap. Instead, it is more of a reflection of the external sector crisis Sri Lanka is facing. It is indeed more alarming and concerning than a Chinese debt trap and reflects a far bigger crisis stemming from the reduction of trade, persistent twin deficits (trade deficit and budget deficit), and the middle income trap.

This hypothesis identifying the economic risks confronted by Sri Lanka in light of upgrading into middle income status is being studied by several researchers who provide vital insights to the discussion. Nilanthi Samaranayaka, in her analysis about Chinese relations with South Asian countries, explains that a combination of factors — low level of FDI and low revenue from exports and remittances — caused difficulties in repaying loans in U.S. dollars, which influenced the decision to exchange the port for FDI. Dr. Dushni Weerakoon and Professor Sisira Jayasuriya also highlight that Sri Lanka's debt problem is not made in China — successive Sri Lankan governments borrowed from international markets despite the persistent fiscal and current account deficits, resulting in a vicious cycle when debt repayments came due.

However, these facts do not justify the Mahinda Rajapaksa government's decision to construct the port using foreign loans obtained at higher interest rates at a time when the country was in dire need of fiscal consolidation. Operation of Hambantota port did not generate sufficient revenue to match the debt obligations pertaining to the loans obtained for the project. Although port operations started in 2011, following the completion of phase one of the project, Hambantota port was still incurring losses by 2016. According to the submissions made to a Parliament committee, the accumulated losses of Hambantota port was 46.7 billion Sri Lankan rupees (approximately $300 million) as of the end of 2016, just before the port was leased to CM Port.

Subsequent to the agreement, the port has gone through some changes and a Terminal Service Agreement (TSA) was signed with NYK, a Japanese shipping company, making it the first roll-on roll-off (RoRo) agreement signed between a Japanese shipping line and a Sri Lankan port. Subsequently, the port reached its one million MT benchmark for 2019 due to strengthened activities in the RoRo, bulk, and liquid cargo sectors.

What must be remembered is that the government is still obliged to pay a little over $100 million every year as loan repayments pertaining to the Hambantota port project. Although the debt repayment now is the responsibility of the General Treasury, the revenue generated by the port is still a vital factor given the fiscal constraints of the government. It is true that port operations have expanded since Hambantota was leased to CM Port. However, whether the port will make sufficient revenue to assist with the debt servicing, or to increase foreign currency inflows to support Sri Lanka's overall balance of payment, is yet to be proven.

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