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Sri Lanka - China Economic Relations in Comparative Perspective
Ample Room to Grow

N.P. Ravindra Deyshappriya¹

Abstract

China and Sri Lanka have extensive historical links, initially religious and cultural, and later also economic. The strategic location of Sri Lanka, between key shipping lanes and the so-called '*String of Pearls*', has significantly enhanced the two countries' economic relations in recent years. This paper examines the state of those relations in two comparative contexts: focusing on how trade, investment and tourism relations have developed over *time*; and how they compare to China's economic links with other countries in the *region*. The results highlight a number of findings and contrasts. First, while a flood of imports from China and sluggish exports to China have resulted in a dramatic trade deficit of Sri Lanka, imports from China remain vital for Sri Lanka's garment industry, which drives Sri Lankan exports. Second, although China has been the top FDI donor and lender to Sri Lanka in recent years, Chinese FDI to Sri Lanka is still very low compared to China's FDI inflows to other Asian countries. This relative gap, together with Sri Lanka's status as a founding member of the newly-established AIIB, indicates that Sri Lanka has potential to seek and attract more investments, grants and loans from China. Third, although China is the fastest growing source of tourist arrivals to Sri Lanka, Sri Lanka is currently not even among the top 25 tourist destinations of China. The share of Chinese tourist arrivals to Sri Lanka is just 0.06% of China's total outbound tourists, and it is drastically lower than the number of outbound Chinese tourists to other Asian countries. To have more beneficial economic relations, the paper recommends new export products that are increasingly demanded in Chinese markets, and which have lower or no tariffs applied to Sri Lankan exports. It also recommends Sri Lanka maintaining a higher level of credibility among potential investors, including via its legal framework. Finally, it advocates promoting Sri Lanka as a tourism destination among growing China's middle class, including by facilitating Chinese tourists appropriately. Each of these would address the ample 'room to grow' in trade, investment, and tourism.

Keywords: Economic Growth, Trade Deficit, String of Pearls, Trade Agreements, Sri Lanka - China Economic Relations.

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01. Introduction

01.1. Background

With a GDP of 10,982.83 US\$ billion, China has become the world's second largest economy with growing influence throughout the Asian region. Sri Lanka is a small economy that is ranked as a lower middle income country, but which has nevertheless achieved significant economic improvements in recent years. Irrespective of the sizes of their economies, Sri Lanka and China have developed substantial links over time, providing a model of good relations between large and small economies. Diplomatic ties that have lasted for 60 years between the two countries have mutually benefited both countries, and currently both nations are looking for greater and more effective links in the future. Sri Lanka's strategic location in the Indian Ocean has particularly attracted China's attention recently, due to its economic and strategic reasons. Despite increasing discussion of these aspects, there remains limited scholarly works that focus on Sri Lankan - Chinese relations, leave a significant gap to be filled. Specifically, the lack of evidence-based, empirical research on economic relations between the two countries hinders the possibility of predicting their future bilateral economic prospects.

This paper aims to redress that gap by providing a comparative analysis of Sri Lankan - Chinese economic relations, focusing on trade, investment and tourism relations between two countries. The paper enriches the existing literature in two ways. Firstly, the paper provides a dual comparative analysis through (i) a time series comparative analysis, and (ii) a cross-country based comparative analysis of Sri Lankan - Chinese economic relations. Secondly, it recognizes the tourism sector as a crucial source of economic growth, especially in an island nation such as Sri Lanka. Tourism-based relations between Sri Lanka and China have not been addressed in academic literature, despite the fast-growing ties in tourism between the countries in recent years. Consequently, the current study analyzes tourism linkages between the two countries and places them in a comparative regional context.

The next section of the introduction elaborates on the evolution of Sri Lankan - Chinese relations during the periods of pre-independence, post-independence and in the 21st century. The second section of the paper empirically analyzes how Sri Lankan - Chinese economic relations have grown over time, while the third section mainly focuses on Sri Lankan - Chinese economic relations in a regional context. The final section of the paper concludes the findings, followed by policy recommendations.

01.2. Evolution

Pre-Independence Relations

Sri Lankan - Chinese historical relations have existed for centuries. Ancient relations were mainly based on religious and cultural links, rather than on commerce or trade. A beginning milestone in these relations was the great traveler monk from China; Fa Xian, who visited Sri Lanka in 411 during the reign of King Mahanama. Monk Fa Xian, who had travelled to several countries in search of Buddhism, ultimately stayed in Sri Lanka for approximately 2 years. He had a great interest in Sri Lanka, and referred to it as "*Island of the Lions*". Fa Xian visited Anuradhapura and studied Buddhism and related areas, as well as the state of the country. It is believed that he offered a valuable white silk fan with an exquisitely cared ivory handle and inlaid gold to the Abeyagiri monastery on the day he sailed back to China.

Apart from this initial milestone, records indicate that King Mahanama (406-428) sent an emissary with an image of the Buddha to Chinese Emperor Hiao-ou-ti of the Tsin Dynasty, followed by another ambassador who carried a letter and gifts to Chinese courts. The ambassadors reached China in 430 and 435 respectively (Bastiampillai, 1990). According to Kirinde (2002), the Sri Lankan political situation had been dramatically

affected by the Ming Dynasty in China during the 15th century. A Chinese general, Cheng Ho, who first visited Sri Lanka in 1405, had been instructed by the Chinese emperor to bring the sacred relics of the Tooth and Bowl of the Buddha to China. The Sri Lankan King, Veera Alakeswara, insulted Cheng Ho, and consequently Cheng Ho seized the Sri Lankan King and his family and brought them to China in 1411 as prisoners. However, the Chinese emperor had benevolently released the King and his family, who then returned to Sri Lanka. Moreover, in the 15th century, during the period of King Parakramabahu VI, a Sri Lankan prince had been sent to China as an envoy. However, during the prince's stay in China, another prince seized his throne in Sri Lanka. The prince therefore decided to settle in the Fujian province. He married a young Chinese woman and their descendants still live in the Fujian province and in Taiwan (Kelegama, 2014).

Post-Independence Relations

The development of relations between the two countries soon after Sri Lanka's independence was crucial for both countries. Specifically, the signing of the Rubber - Rice Pact and the establishment of diplomatic relations with China occurred during this period.

The historic Rubber-Rice Pact between Sri Lanka and China was initiated 5 years before diplomatic relations were established between two countries. Mr. R.G. Senanayake, the then Minister of Commerce in Sri Lanka, and his Chinese counterpart, signed the agreement in the presence of China's Prime Minister on the 18th of December 1952. The deal was significant as the first trade agreement that China signed with a non-communist country. The agreement was renewed every five years until 1982 (Kelegama, 2014). According to this trade agreement, Sri Lanka committed to import 270,000 metric tons of rice from China annually and in return, China agreed to import 50,000 tons of rubber from Sri Lanka each year for five years.

The Rubber-Rice Pact was a timely and critical trade agreement for both countries, for a few reasons. Sri Lanka was struggling to deal with dramatically increased international rice prices and sharply declined rubber prices due to a world-wide rice shortage and the introduction of synthetic rubber. Correspondingly, during this period, China had a surplus of rice, and China found it difficult to purchase natural rubber due to the economic sanctions placed upon it by the United Nations. Hence, both countries mutually benefited from the pact and Sri Lanka was offered a 40% higher-than-market price for rubber, while importing rice at one third of the market price.

Sri Lanka established formal diplomatic relations with China in 1957. Mr. Wilmot A. Perera was the first Sri Lankan ambassador to China (1957-1960). The diplomatic relations between two countries laid a solid foundation for both economic and political ties. The first agreement on Economic and Technical Cooperation was signed in 1962, following the historic visit of then Sri Lankan Prime Minister, Sirimavo Bandaranaike, to China. The Sri Lankan Prime Minister's visit was very successful in securing and expanding Chinese assistance, especially for the construction of the Bandaranaike Memorial Conference Hall (BMICH).

Soon after her visit, in 1963, the two nations signed an agreement on their maritime relations. This agreement allowed commercial vessels to engage in operations between Sri Lanka and China or other third countries, and to be treated by Sri Lanka and China as bearing each other's Most Favored Nation (MFN) status (Kelegama, 2014). A Sri Lankan - Chinese Society, which closely works with China's Embassy in Sri Lanka, was created on the 5th of October 1981. The main objective of this society was to strengthen the relationship between the two countries. The society has forged a close relationship with the Chinese People's Association for Friendship with Foreign Countries (CPAFFC), which has a very strong reputation in China.

Both countries realized the need for a ‘general trade pact’ to expand their trade relations. They therefore formed the Sino-Sri Lanka Joint Trade Committee in 1982, to review the implementation of the agreement and marched one step ahead to sign an Agreement on Economic & Trade Cooperation in 1984. However, the Sino-Sri Lanka Joint Trade Committee (1982) and the Agreement on Economic & Trade Cooperation (1984) were merged in 1991, to form the Sri Lankan – Chinese Joint Commission. The initial meeting of the Sri Lankan - Chinese Joint Commission was held in 1992, followed by the second and third sessions in 1996 and 2000 respectively. The Joint Commission had broader objectives than trade relations, including exchanging information, organizing trade missions and delegations on conciliatory negotiations and releasing loan facilities for various development projects. In addition, the commission laid a foundation for tourism relations through cultural and religious engagements.

In 1994, Sri Lankan - Chinese Business Council was established, by integrating the leading private sector business partners in both countries, and was sponsored by the Ceylon Chamber of Commerce. The key objective of the Business Council is to expand and improve trade and investment relations between the two countries.

Bilateral Relations in the 21st Century

China - Sri Lanka relations in the 21st century have been robust, with a number of high-profile meetings held in both countries which were attended by leading representatives of both countries. These high profile meetings have contributed to the maintaining and further strengthening of friendly relations between the two countries in the last few decades. Table 01 summarizes the high-profile meetings held during the period 2003 – 2016.

Table 01: High-Profile Meetings between Sri Lanka and China 2004 - 2016

Date	Sri Lankan Member	Chinese Member	Location
Aug-03	PM: R. Wickremesinghe	President: Hu Jintao	Beijing
Nov-04	President: C.B. Kumaratunga	State Councilor: Chen	Colombo
Dec-04	Foreign Min. L. Kadirgamar	State Councilor: Chen	Beijing
Apr-05	President: C.B. Kumaratunga	Premier: Wen	Colombo
Aug-05	President: C.B. Kumaratunga	President: Hu Jintao	Beijing
Mar-06	President: M. Rajapaksa	State Councilor: Tang	Colombo
Jul-06	Foreign Min. M. Samaraweera	Premier: Wen	Beijing
Sep-06	Finance Min. Jayasundera	Exim Bank, Assis. Manager: Li	Colombo
Mar-07	President: M. Rajapaksa	President: Hu Jintao	Beijing
Oct-07	Finance Min. Jayasundera	Exim Bank Chairman: Li	Colombo
Dec-07	Foreign Min. Bogollagama	Deputy Mayor: Tang	Shanghai
Apr-08	President: M. Rajapaksa	President: Hu Jintao	Hainan
Aug-08	President: M. Rajapaksa	President: Hu Jintao	Beijing
Sep-08	President: M. Rajapaksa	Foreign Min. Yang	Colombo
Oct-08	PM: Wickramanayake	Yunnan Governor: Qin	Kunming
Jul-09	Foreign Min. Bogollagama	Vice Premier: Li	Beijing
Aug-09	Foreign Min. Bogollagama	Yunnan Vice-Governor: Gao	Colombo
Aug-09	Treasury Secretary: Abeysinghe	Exim Bank Vice President: Zhu	Beijing
Sep-09	President: M. Rajapaksa	Tianjin CPC Chief: Zhang	Colombo
Oct-09	PM. Wickramanayake	Premier: Wen	Chengdu
Dec-09	Treasury Secretary: Abeysinghe	Commerce Vice Min. Chen	Beijing

Jun-10	President: M. Rajapaksa	Chinese Vice-Premier: Zhang Dejiang	Colombo
Aug-10	PM: D.M. Jayaratne	Governor : Qin Guangrong	Colombo
Jun-11	President: M. Rajapaksa	President: Hu Jintao	Russia
Aug-11	President: M. Rajapaksa	Premier: Wen Jiabao	Zhongnanhai
Sep-12	President: M. Rajapaksa	Wu Bangguo	Colombo
May-13	President: M. Rajapaksa	President: Xi Jinping	Beijing
Sep-13	President: M. Rajapaksa	Liu Yunshan	Colombo
Jun-13	PM. D.M. Jayaratne	Vice Premier: Ma Kai	Kunming
May-14	President: M. Rajapaksa	President: Xi Jinping	Shanghai
Sep-14	President: M. Rajapaksa	President: Xi Jinping	Colombo
Nov-15	President: M. Rajapaksa	President: Xi Jinping	Hainan
Apr-16	PM. R. Wickremesinghe	President: Xi Jinping	Beijing

Source: Created by author using Kelegama (2014), Samaranayake (2011) and various reports of the Ministry of Foreign Affairs, Sri Lanka

The golden jubilee celebration of Sri Lankan - Chinese diplomatic relations, in 2007, was a landmark in bilateral relations. Former President Mahinda Rajapaksa visited China that year for the official celebrations, and signed two bilateral agreements: the Economic and Technical Cooperation agreement, and the Friendship City Relationship agreement between the city of Guangzhou of China and the District of Hambantota of Sri Lanka. Apart from that, several Memorandums of Understanding (MoUs) were signed by then President Rajapaksa with China's Ministry of Construction, Ministry of Commerce, the Film Bureau of the State Administration of Radio, Film and Television of China, the Red Cross Society of China, the Chinese Academy of Agricultural Mechanization Sciences, and the Beijing Foreign Studies University of China. In addition to these MoUs, the China Development Bank and Central Bank of Sri Lanka entered into an Investment Facilitation Agreement to strengthen the long-term economic linkages between the two banks.

Furthermore, Sri Lankan - Chinese relations in 21st century can be considered the era of China-centric infrastructure development. Extended high-profile meetings helped to attract a significant number of large-scale infrastructure development projects to Sri Lanka. Specifically, after the end of the civil war in Sri Lanka in 2009, China became the key sponsor for most of the 'mega infrastructure' development projects in Sri Lanka. China has funded the Norochcholai Power Station, Mattala Airport, Hambantota Sea Port, Southern and Katunayake Expressways, *Nelum Pokuna* (Lotus Pond) Theater, Lotus Tower in central Colombo, Colombo Port City (now renamed the International Financial City) projects, and the Northern Road Rehabilitation Projects. There remains debate as to the interest rate attached to the loans, and other conditions of Chinese aid and loans. At the same time, however, it is clear that the aforementioned infrastructure development projects could not have become a reality without the financial and technical assistance of China.

The recently established Asian Infrastructure Development Bank (AIIB), described as the Chinese "World Bank", appears to be more flexible at providing development assistance to its members than its global competitor institutions. Sri Lanka signed an initial MoU with the AIIB on the 24th of October 2014. It joined the AIIB on 29th June 2015, and ratified its entry on the 22nd of June 2016 as a founding member of the AIIB. Sri Lanka's integration with the AIIB exhibits its close relations with China, as well as Sri Lanka's expectation to have more financial and technical assistance through the AIIB in order to develop quality infrastructure in Sri Lanka.

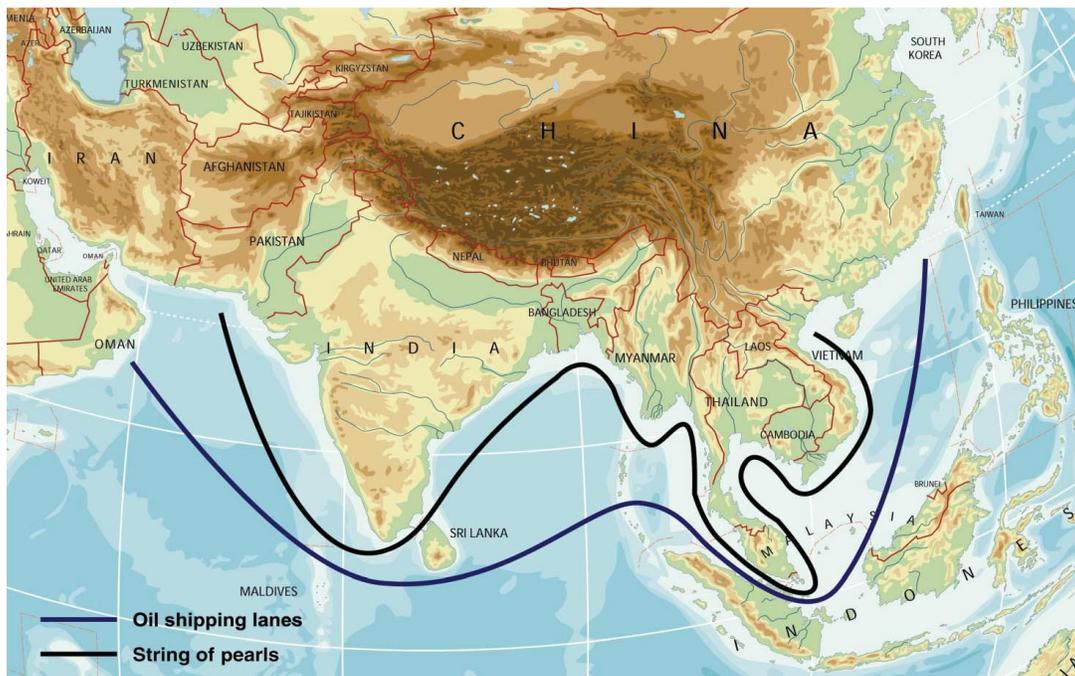
02. Have Sri Lanka - China Economic Relations Been Growing? A Time-Based Analysis

The previous section elaborated on how Sri Lankan - Chinese relations have evolved over time. This section more specifically examines whether economic relations between the two countries have progressed, with reference to empirical evidence. These economic relations are analyzed with respect to three main dimensions: trade; investment; and tourism. A time-based comparative analysis is applied to examine the trends of each dimension.

02.1. Trade Relations

Sri Lanka's location at the midpoint of the shipping lane that connects the Asia-Pacific region, now the central source of world economic growth, with the Middle East and Africa (MENA) region, which remains the world's energy and resource center, has been a crucial factor in Sri Lanka engagement with its trading partners. Moreover, Sri Lanka is considered one of the pearls of China's *String of Pearls*; a concept that has gained traction in recent years because of China's increasing engagement with countries in the Indian Ocean Region.

Figure 01: Sri Lanka's Strategical Location between both the Oil Shipping Line and the String of Pearls



Source: Samaranayake (2011)

According to MacDonald *et al* (2004), China's "String of Pearls" is a set of strategic relationships along the sea-line in the Indian Ocean region, from the Middle East to East Asia, and its main objective is to establish more secure and stable oil transportation to China through the Malacca Strait. China's concerns about the shipping lane at Malacca Strait becoming blocked led to President Hu Jintao highlighting the notion in 2003 (Lam, 2004).

“Chinese policy planners have long feared a retaliatory US naval blockade of the Strait of Malacca to cut off vital oil supplies. In a 2003 speech, President Hu Jintao even acknowledged China’s vulnerability in the Strait”. (Samaranayake, 2011)

In fact, Sri Lanka is fortunately located in between both the shipping lane and the String of Pearls, a strategic position that has attracted China’s attention and in turn has spurred the expansion of trade relations in the recent past.

Table 02: Sri Lanka’s Top 05 Export and Import Destinations from 1990 to 2015

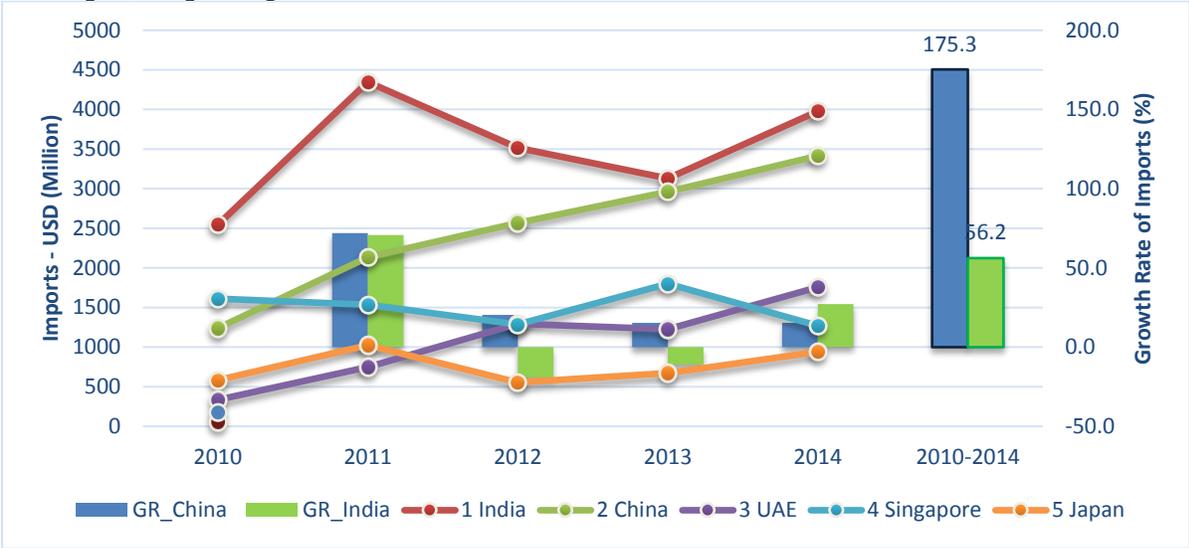
Year	Top 5 countries to which Sri Lanka exports goods (Millions) (country’s share of all exports from Sri Lanka is in parentheses)	Top 5 countries from which Sri Lanka imports goods (Millions) (country’s share of all imports to Sri Lanka is in parentheses)
1990	United States – US\$ 493 (25.75%) Germany – US\$ 127 (6.63%) UK – US\$ 115 (6.02%) Japan – US\$ 102 (5.35%) Belgium – US\$ 97 (5.07%)	Japan – US\$ 325 (12.35%) Iran – US\$ 222 (8.44%) United States – US\$ 208 (7.88%) Other Asian – US\$ 156 (5.91%) UK – US\$ 146 (5.54%)
2000	United States – US\$ 2149 (40.26%) UK – US\$ 722 (13.53%) Germany – US\$ 226 (4.23%) Japan – US\$ 225 (4.22%) Belgium – US\$ 153 (2.86%)	Japan – US\$ 634 (10.26%) India – US\$ 589 (9.53%) Hong Kong – US\$ 506 (8.19%) Singapore – US\$ 487 (7.88%) South Korea – US\$ 389 (6.30%)
2010	United States – US\$ 1768 (21.29%) UK – US\$ 1022 (12.31%) India – US\$ 467 (5.63%) Italy – US\$ 463 (5.58%) Germany – US\$ 401 (4.82%)	India – US\$ 2549 (20.64%) Singapore – US\$ 1615 (13.08%) China – US\$ 1242 (10.05%) Iran – US\$ 658 (5.33%) Japan – US\$ 485 (4.73%)
2015	United States – US\$ 2801 (26.83%) UK – US\$ 1028 (9.85%) India – US\$ 710 (4.58%) Germany – US\$ 478 (4.58%) Italy – US\$ 434 (4.16%)	India – US\$ 4268 (22.50%) China – US\$ 3727 (19.65%) Japan – US\$ 1388 (7.32%) UAE – US\$ 1073 (5.66%) Singapore – US\$ 923 (4.87%)

Source: Created by author based on the World Integrated Trade Solution of the World Bank.

Table 02 summarizes Sri Lanka’s top five trading partners over the last three decades. According to the table, it is apparent that China was not a major trading partner of Sri Lanka during 1990 – 2000, and that the United States and Japan were the top export and import partners, respectively. China’s importance as an importer into Sri Lanka emerged only during the latter part of the 2000s. By 2007 and 2011, China was Sri Lanka’s third and second largest import partner, respectively.

China has continuously been the second best importing partner of Sri Lanka since 2011 and its share of imports has increased steadily over this period. By 2015, China’s imports to Sri Lanka stood at US\$ 3727 million, which accounted for 19.65% total imports of Sri Lanka. Despite India’s position as the top import partner of Sri Lanka, total trade (both imports and exports) between Sri Lanka and China has doubled; from US\$ 125.6 million to US\$ 256.2 million in the 10 years from 1990 to 2000. China’s emergence as an import partner of Sri Lanka is depicted in figure 02. Imports from China have steadily increased from 2010 onwards, while imports from other top import partner countries have fluctuated over this time.

Figure 02: The Recent Trends of Sri Lanka Imports from Top Five (India, China, UAE, Singapore and Japan) Importing Destinations.

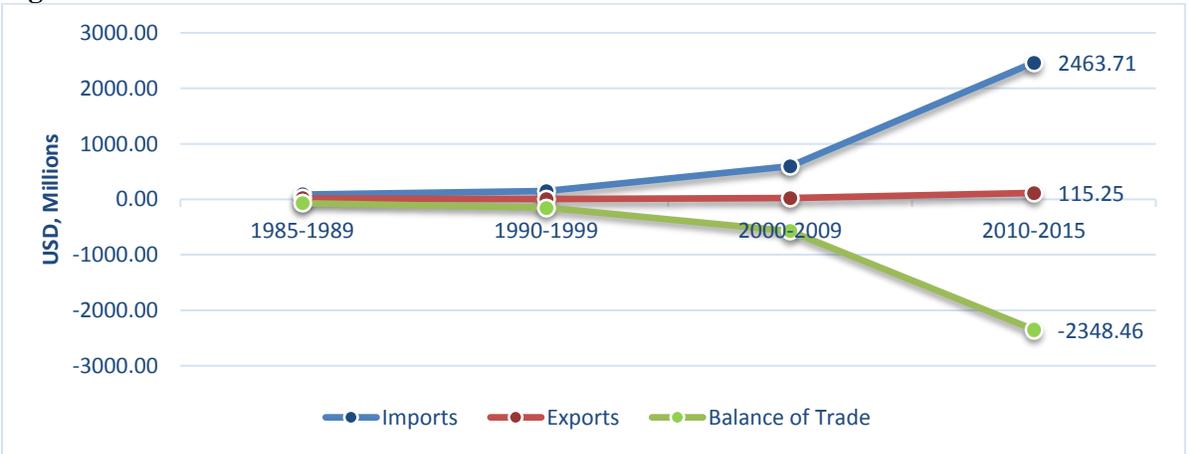


Source: Created by author, based on the data from Export Development Board, Sri Lanka (2015)

The bars in figure 02 indicate the *annual growth rate* of imports from the leading importing partners of Sri Lanka (India and China), along with their growth rates for the period 2010-2014. It shows that, despite the fact that India remains the top source of imports, the growth rate of imports from China is greater than that of India, except in 2014, and furthermore, India had a negative growth rate in both 2011 and 2012. Moreover, the overall growth rate of China’s imports during 2010-2014 was 175.3%, while imports from India grew at just 56.2%.

Even though China is a crucial source of imports for Sri Lanka, China’s significance as an exporting destination is considerably low. China has not featured among the top 10 export destinations of Sri Lanka and is currently ranked 14th, as of 2014. Specifically, Sri Lanka’s exports to China in 2014 were US\$ 173.5 million, accounting for just 1.5% of Sri Lanka’s total exports in 2014. Sri Lanka’s sluggish exports to China, along with the dramatic increase of imports, especially after 2000, are clearly indicated in figure 03 below.

Figure 03: Trade Flows and Balance of Trade between Sri Lanka and China 1985 - 2015

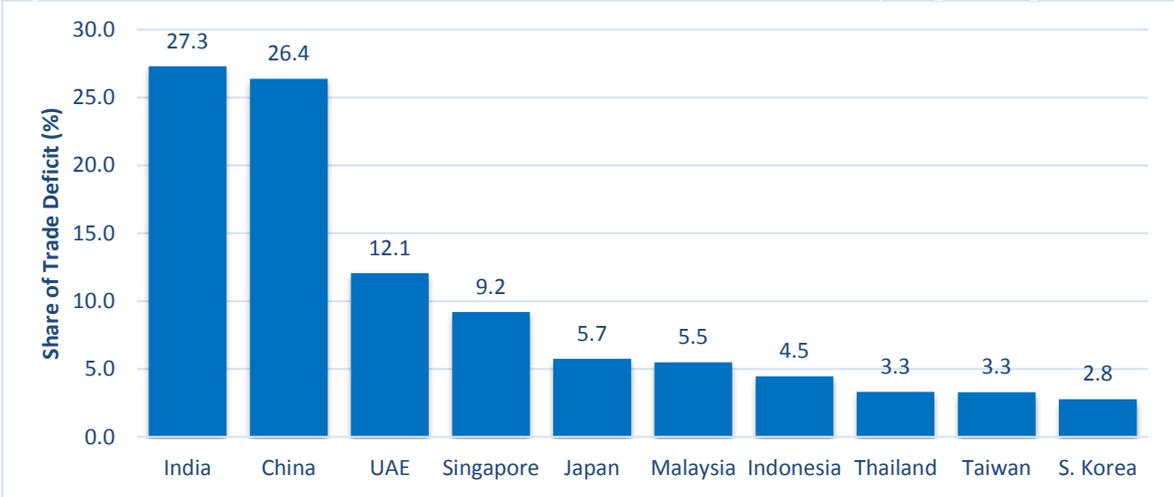


Source: Created by author, based on data from Export Development Board, Central Bank and Sri Lanka Customs

The average imports from China during the period of 1985-1989 increased by approximately 29-fold by 2010-2015, whereas exports to China increased by only 7-fold. This import-centric trade relationship between Sri Lanka and China has created a severe trade deficit for Sri Lanka. As the graph shows, Sri Lanka's balance of trade with China has been negative, and the trade deficit started to deepen during the period of 2000-2009, with the rapid expansion of imports.

According to figure 04 below, the deepening trade deficit caused by trade flows between Sri Lanka and China has accounted for 26.4% of Sri Lanka's total trade deficit, while trade flows with India represent 27.3% of Sri Lanka's trade deficit in 2014. Hence, it is apparent that both India and China; the first and second importing partners of Sri Lanka, together account for more than 50% of Sri Lanka's trade deficit.

Figure 04: Shares of Trade Deficit out of Total Trade Deficit created by Top 10 Import Partners



Source: Created by author, based on data from the Export Development Board (2015), the Central Bank (2015) and Sri Lanka Customs (2015).

Although trade flows between Sri Lanka and China cause a large trade deficit for Sri Lanka, the expanding deficit is not a major issue under liberalized and globalized economic conditions (Kelegama, 2014). Specifically, major imported products from China such as knitted and crocheted fabric of artificial filament, woven fabric of synthetic staple fibers, and dyed cotton are the raw materials of producing our main exports, particularly garments and textiles.

Consequently, imports from China are vital for Sri Lanka to expand its textile industry, in order to ensure growing demand for Sri Lanka's garment products. Further, imports from China include electronic products and consumer durables such as air conditioners, cameras, televisions, washing machines and mobile phones, products for which Sri Lanka does not have a comparative advantage in production. The import of these products from China is therefore still crucial for Sri Lanka (Fernando, 2010), and overall, trade relations between Sri Lanka and China are mutually beneficial for both countries.

02.2. Investment Relations

As a developing country, Sri Lanka has been looking for investment relations with industrialized countries in order to expand its industrial sector and expedite its economic growth. Sri Lanka has been successful in attracting a significant amount of Chinese investments in recent years, relative to the investment inflows from other countries. Although both trade and investment relations between Sri Lanka and China are equally important for both countries, Chinese investments in Sri Lanka have attracted more local and

international attention than trade relations, as the scale of recent Chinese investments in Sri Lanka appears significantly large. This section observes investment relations between Sri Lanka and China focusing on infrastructure development, Foreign Direct Investment (FDI), foreign borrowings and aid, as well as foreign financing commitments and disbursements.

Infrastructure Development

According to the notion of a “String of Pearls”, China has identified Sri Lanka as one of the crucial locations on a key shipping lane and the string of pearls. China has therefore tried to build a closer strategic relationship with Sri Lanka by providing ‘mega investment’ projects which have not yet been facilitated by any other country. There are a few factors which contributed to this unique status of China. After Sri Lanka was designated as a lower middle-income country, concessional loans and aid from Western multilateral organizations such as the IMF and the World Bank became more limited. Sri Lanka therefore had to strengthen its bilateral relations with regional countries such as China and India, in order to secure the financial assistance and investment opportunities it required. In addition, the loans and assistance from Western entities often involve a number of restrictions and conditions such as structural reforms and human rights conditions. In the recent past, however, Sri Lanka’s government looked for quick loans and assistance with minimal prerequisites, and China was the only bilateral partner that could meet Sri Lanka’s expectations.

The very large scale of China’s resulting developmental assistance, and the fact that it is free of prerequisites associated with Western aid, have therefore both contributed to global attention on investment relations between Sri Lanka and China. Some notable observations of this include the following statements.

“With Chinese investment, Sri Lanka can get ports and doesn’t get lectures on economic reform and human rights – Ashley Wills, former US ambassador to Sri Lanka” (Samaranayake, 2011)

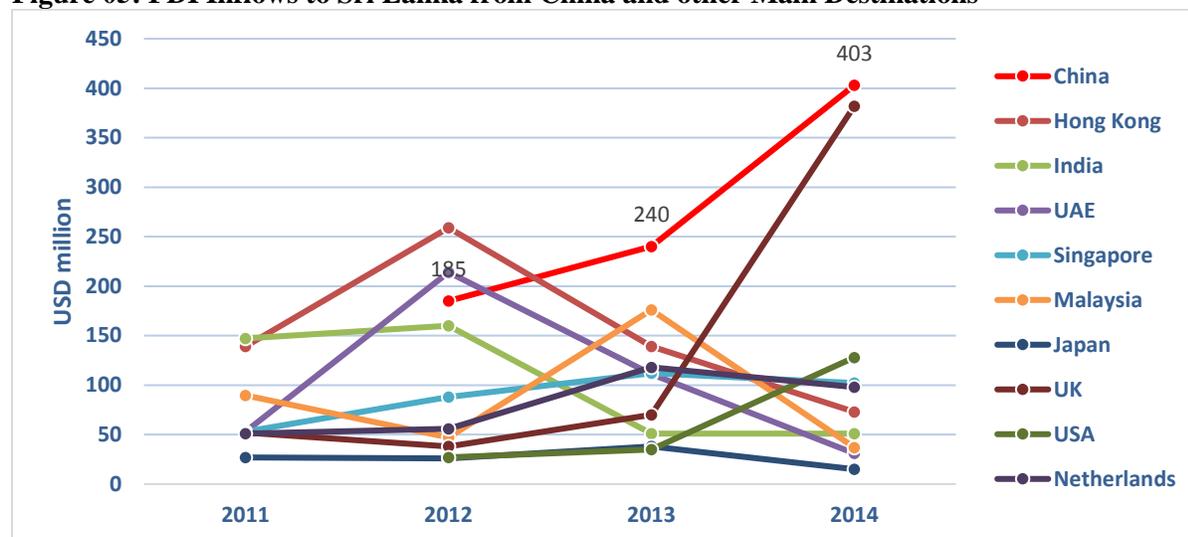
“China’s aid to Sri Lanka jumped from a few million dollars in 2005 to almost \$1 billion last year (2008), replacing Japan as the biggest foreign donor” – *Times of London, May 2009*. (Samaranayake, 2011).

Foreign Direct Investment (FDI)

According to Kelegama (2014), the Sri Lankan - Chinese Business Cooperation Council (SLCBCC) has played a vital role in attracting and guiding Chinese investors. The Council has provided appropriate information for both Chinese and Sri Lankan investors by arranging relevant events such as “Kunming Trade Fair” in 2011-2013 and “How to Do Business in China”, which provided better understanding about business culture in China. In addition to the role of the SLCBCC, the Sri Lankan government has provided Sri Lankan passports to Chinese investors on the basis of the “Second Home” passport – for those who invest at least 25 US\$ million (Fernando, 2010).

Foreign Direct Investment (FDI) is vital to investment relations, and scholarly works empirically recognize FDI as a source of economic growth especially in developing countries. However, in early 2000, FDI inflows from China to Sri Lanka were limited. According to Samaranayake (2011), FDI inflows from China to Sri Lanka were just UD\$ 61.7 million during the years 2003-2008.

Figure 05: FDI Inflows to Sri Lanka from China and other Main Destinations



Source: Created by author based on Board of Investment Annual Reports 2011-2014

Figure 05 shows the FDI inflows to Sri Lanka in 2011-2014 on annual basis. It indicates that China was the third largest FDI donor country for Sri Lanka in 2012, while Hong Kong (considered as a separate investment source to mainland China) and the UAE were reported to be ranked first and second, respectively. China's FDI inflows to Sri Lanka in 2012 were US\$ 185 million. After 2012, FDI inflows from both Hong Kong and the UAE declined sharply, while inflows of FDI from China increased steadily to US\$ 403 million by 2014. Notably, by 2014, China had become the largest FDI donor country, followed by the UK. Chinese FDIs were largely in the telecommunications, garments, power and energy, and electronic manufacturing sectors in Sri Lanka.

Table 04 highlights the performance of FDI inflows to Sri Lanka from its main FDI donors over a five-year period. With a total FDI of US\$ 828 million during the years 2011-2014, China is clearly the top FDI donor country of Sri Lanka in this period. Furthermore, the inflows of China's FDI during this period are significantly higher than both Hong Kong and UK, who are the second and third largest donors respectively.

Table 04: Performance of FDI Inflows from China and other Main Destinations

Country	Total FDI (US\$ Million) (2011-2014)	Share of FDI as % of Total FDI Inflows (2014)	Growth Rate of FDI 2011-2014
China	828	24.53	117.84
UK	542	23.25	634.62
United States	190	7.79	374.07
Singapore	355	6.21	92.45
Netherlands	323	5.96	92.16
Hong Kong	610	4.44	-47.48
India	409	3.10	-65.48
Malaysia	350	2.25	-58.66
UAE	409	1.89	41.51
Japan	106	0.91	-44.44

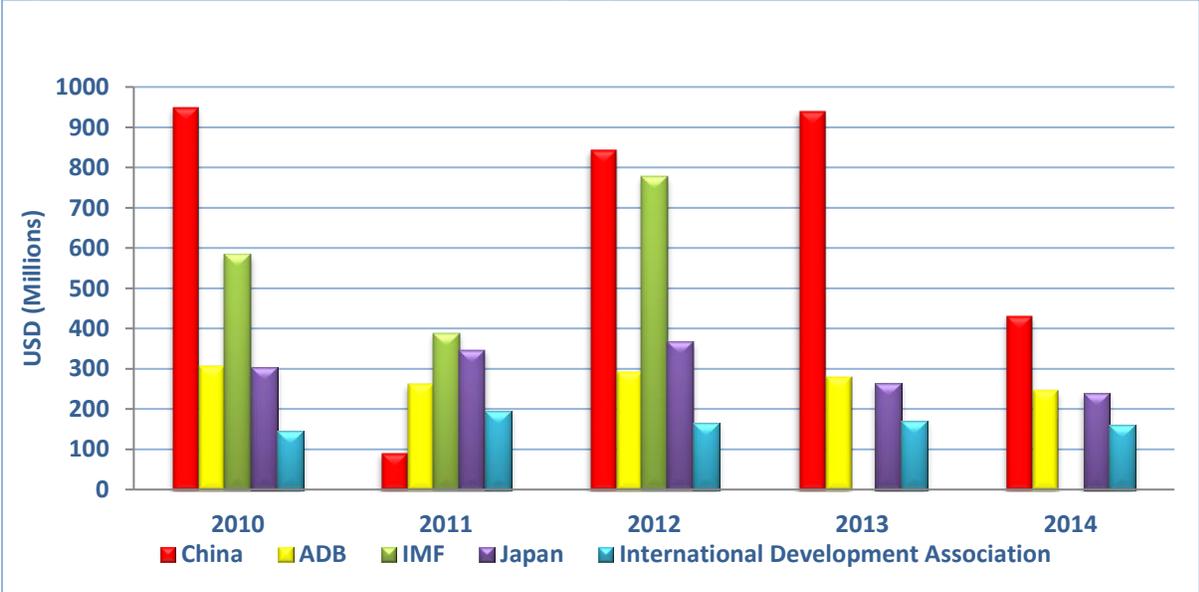
Source: Created by author based on Board of Investment Annual Reports 2010-2014

Consistent with the increasing numbers, China accounted for the largest share (24.53%) of total FDI inflows to Sri Lanka in 2014. Similarly, FDI inflows from China grew at 117.84% during the period of 2011-2014 while FDI inflows from most of other Asian countries such as India, Malaysia, Hong Kong and Japan recorded a negative growth rate. Despite USA and UK have recorded significantly higher FDI growth rates during the period of 2011-2014, as the figure 04 indicates, the volume of FDI inflows from USA and UK were dramatically low till 2013, compared to the volume of FDI from China. Moreover, the higher FDI growth rate of USA and UK is mainly due to large inflows of FDI between 2013 and 2014. Nevertheless in general, it is apparent that Sri Lanka’s bilateral relations with China acquired increased significance, in order to ensure the required level of FDI inflows to Sri Lanka.

Foreign borrowings and aid

Apart from being a favorable FDI donor country, China has been a crucial provider of loans and grants to Sri Lanka. As figure 06 depicts, China has been by far the largest lender to Sri Lanka during the period of 2010-2014, except in 2001. According to the graph, it is evident that China has continued to facilitate loans to Sri Lanka, while loans have been relatively limited from more Western entities such as the IMF, World Bank, and even the Asian Development Bank.

Figure 06: Sri Lanka Government Borrowings by Lenders (2010 – 2014)



Source: Created by author based on the data from Annual Reports of Central Bank of Sri Lanka 2010-2014 and the International Monetary Fund

To state the numbers in comparative perspective, 37.2% of Sri Lanka’s total foreign borrowings during the period of 2010-2014 came from China, while the IMF and ADB granted 20% and 15.8%, respectively. As indicated in Table 05, most of the Chinese borrowings were from either state-owned or state-affiliated banks in China. The Export-Import Bank of China, in particular, has been a key player, by providing loans amounting to US\$ 2,275.3 million in 2010-2014, out of the US\$ 3,257.2 million total borrowings from China during that period.

Table 05: Main Sources of Government Borrowings from China (US\$ Million)

Sources of Chinese Borrowings	2010	2011	2012	2013	2014	Cumulative Total
Export-Import Bank of China	692.2	17.1	615	810	141	2275.3
China Development Bank Corporation	152.8	75.4	229	129	292	878.2
Government of the People's Republic of China	103.7					103.7
Total Borrowings from China						3257.2

Source: Created by author based on the data from Annual Reports of Central Bank of Sri Lanka 2010-2014 and the International Monetary Fund

Similarly, the China Development Bank Corporation has also consistently financed Sri Lanka's foreign borrowing requirements, allocating US\$ 878.2 million in loans to Sri Lanka during 2010-2014. Most of the loans received from Chinese banks have been used for infrastructure development in Sri Lanka. Table 06 lists selected major projects carried out with China's technical and financial assistance, since 1973.

Table 06: Selected Projects in Sri Lanka Completed under Chinese Cooperation

Name of the Project	Cost (US\$ Million)	Year Completed
Bandaranaike Memorial International Conference Hall	2.14	1973
Norochcholai Power Station	1400	2011
Exclusive Economic Zone at Mirigama	28	2009
Superior Court Complex	3.58	1972
Colombo-Katunayake Expressway	248.2	2013
Lotus Pond Theatre	30	2011
Mattala International Airport	210	2013
Polonnaruwa Water Supply & Sanitation Project	32.93	2010
Hambantota Port Development Project (Phase I & II)	461	
Moragahanka Reservoir Project (Stage I)	370	To be opened

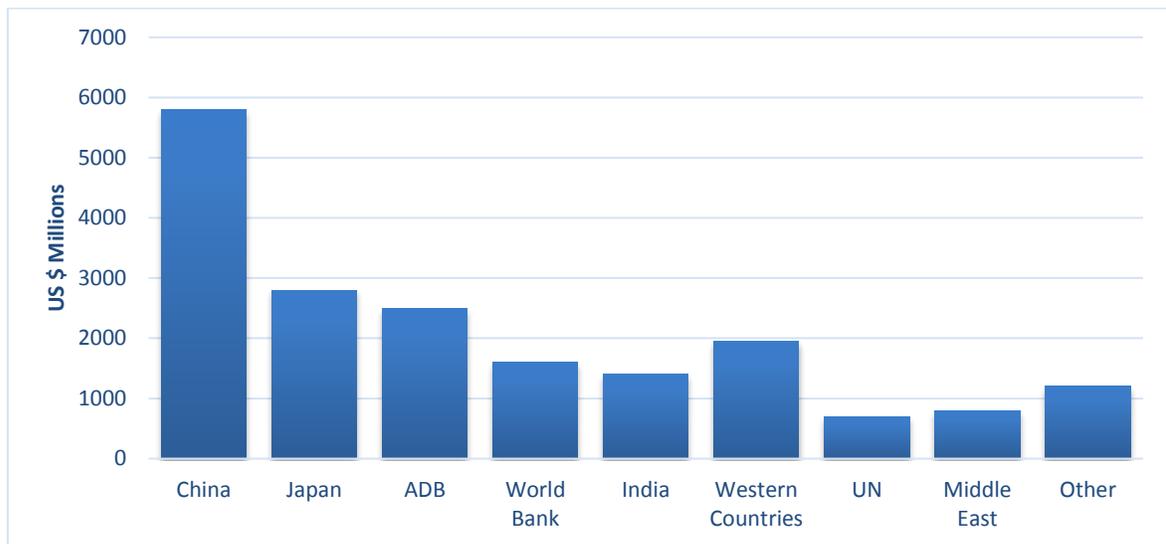
Source: Created by author based on Kelegama (2014) and Samaranayake (2011)

Of all the listed projects, Norochcholai was the largest, costing US\$ 1400 million. It was financed by China through a concessionary loan. In addition, the Exclusive Economic Zone (EEZ) in Mirigama, although of a relatively lower cost, was a very important project as it allocated a specific area to attract foreign investors for the first time in Sri Lanka's history. There are plans for the EEZ to be expanded to both the Southern and Eastern Provinces of Sri Lanka, depending on the progress of the EEZ in Mirigama. Similarly, the Colombo-Katunayake Expressway was the main infrastructure development project in the transport sector while Hambantota seaport and Mattala airport were intended to advance the maritime and aviation sectors, respectively. With regard to future infrastructure projects, the planned International Financial City (previously called the Port City), located in Colombo, is expected to become a financial hub of the Indian subcontinent, and more broadly, of the Indian Ocean region.

Foreign Financing Commitments and Disbursements

Aside from foreign borrowings, foreign financial commitments, which take both loans and grants into account, are a good indicator of the strength of bilateral relations. During the period 2006 - 2013, China's foreign financing commitments to Sri Lanka amounted to US\$ 5800 million and outnumbered the commitments of all of Sri Lanka's other partners. Moreover, none of Sri Lanka's other partners and institutions, including Japan, the ADB and the World Bank had financially committed even half the amount that China had committed during the period 2006-2013.

Figure 07: Foreign Financing Commitments (Total) from Major Partners (2006 – 2013)



Source: Created by author, based on information of the Ministry of Finance and Planning, Sri Lanka (2013)

Figure 08 clearly illustrates the developmental trend of China’s foreign financing commitments, and in a historical perspective. During the long period of 1971-2004, China’s foreign financing commitments to Sri Lanka were just US\$ 362 million, while its commitments increased dramatically up to US\$ 5,664 million during the six-year period of 2005-2013. As the trend of the commitments indicates, although China’s foreign financing commitments fluctuated during the highlighted period, its commitments in general continued to grow exponentially from 2005 to 2013.

Figure 08: Time Trend of Foreign Financing Commitments from China



Source: Created by author, based on information of the Ministry of Finance and Planning, Sri Lanka (2013)

The majority of China’s foreign financing commitments have been allocated for (i) road and transportation, (ii) power and energy, and (iii) ports development. In 2014, these three sectors received 34%, 30% and 26% of China’s total commitments to Sri Lanka, respectively. The sharp hike in China’s commitments in 2009, illustrated in figure 08, reflects the inflows of China’s aid that focused on war-affected areas in the North and East. Specifically, China provided technical and financial assistance for de-mining projects as well as humanitarian assistance for internally displaced people and resettlement programs (Kelegama, 2014). By contrast, after 2010, most of China’s foreign financing commitments to Sri Lanka have targeted major infrastructure development projects such as Norochcholai Power Station, Hambantota port, Mattala airway, and the Colombo-Katunayake expressway.

There remains little doubt, therefore, that China is a key player in contributing to the physical infrastructure of Sri Lanka’s nation-building process. As detailed below, a similar trend and status can be observed with respect to the development of tourism in Sri Lanka.

02.3. Tourism Relations

Sri Lanka has long been recognized as the “Pearl of the Indian Ocean,” due to its islandic position and natural beauty – aspects which, together with the warm hospitality of its people, attract a significant number of tourists from all over the world. Consequently, the tourism sector has been identified as a major driver of the economic growth of Sri Lanka. In 2014, the tourism sector of Sri Lanka earned US\$ 2431.1 million in tourism receipts and created 129,790 and 170,000 direct and indirect employment opportunities, respectively. Sri Lanka expects to attract four million tourists by 2020, and also plans to be a major tourism hub in the world by 2025. The following table summarizes the share of tourist arrivals from the top three countries during the period 1984-2015.

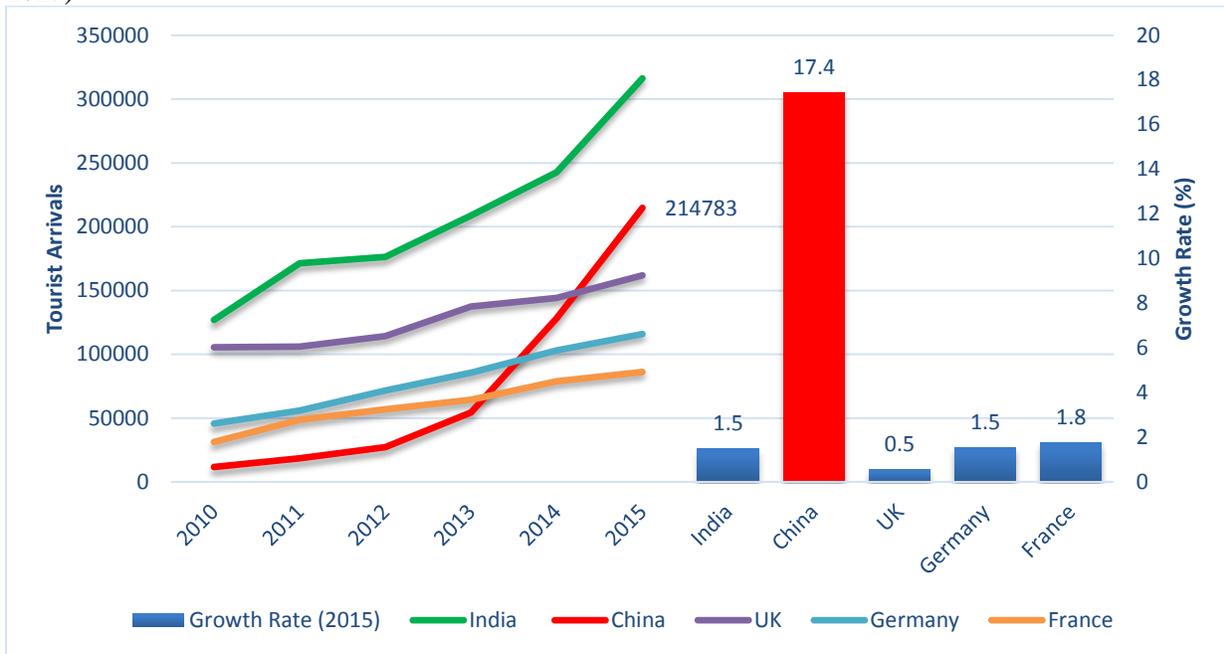
Table 07: Share of Tourist Arrivals to Sri Lanka – Top Three Countries in 1984 to 2015

	China	India	UK	France	Germany
1984	-	13.1%	-	9.4%	18.5%
1994	-	10.8%	18.3%	-	22.9%
2004	-	18.5%	18.8%	-	10.2%
2014	8.4%	15.9%	9.4%	-	-
2015	11.9%	17.5%	9.0%	-	-

Source: Created by author, based on the data from the Sri Lanka Tourism Development Authority.

It is apparent that during the first decade of 1984-1994, tourist arrivals in Sri Lanka were dominated by German tourists, while China was not a major tourism partner of Sri Lanka. In fact, until 2004, Germany, India and the UK constituted the top three sources of tourist arrivals in Sri Lanka, albeit in alternating places as first, second and third. By 2014, however, China had become the third top tourist partner of Sri Lanka, accounting for 8.4% of all tourist arrivals in Sri Lanka. Continuing the trend, China became the second biggest tourism partner of Sri Lanka in terms of tourist arrivals by 2015, pushing the UK into third position, and establishing the emergence of China as a major tourist partner of Sri Lanka. Despite India’s consistent position as a ‘top 3’ source of tourist arrivals since 1984, the sharp rise in Chinese tourist arrivals in recent years indicates the vital role of Chinese tourism in the years to come.

Figure 09: Tourist Arrivals and Growth Rate of Tourist Arrivals from Top Five Countries (2010-2015)



Source: Created by author, based on the data from the Sri Lanka Tourism Development Authority.

Figure 09 presents the total *number* of tourists, as well as the *growth rate* of major sources of tourists, in the five year period 2010-2015, following the end of the war in 2009. According to figure 09, Indian tourists account for by far the largest numbers, followed by arrivals from the UK. Tourist arrivals from China were low compared to the rest of the top tourist partner countries, during the period of 2010-2013. However, Chinese tourist arrivals started to increase dramatically after 2013 and by 2015, a total of 214,783 Chinese tourists visited Sri Lanka, the second highest in terms of tourist arrivals from any country.

Apart from absolute number of tourist arrivals, the growth rate of tourist arrivals shows the significance of China as a tourism partner of Sri Lanka. As figure 09 depicts, Chinese tourist arrivals have grown by 17.4% during the period of 2010-2015 while Indian and UK tourist arrivals grew by 1.5% and 0.5%, respectively. Furthermore, tourist arrivals from China increased by 68% by 2015 compared to 2014 while Indian tourist arrivals grew by only 30%. According to the existing trend, there is a high possibility for China to become the top tourist partner of Sri Lanka in the near future, thereby relegating India to second position. The growing trade and investment relations between China and Sri Lanka also create ample opportunities for the development of the tourism sector.

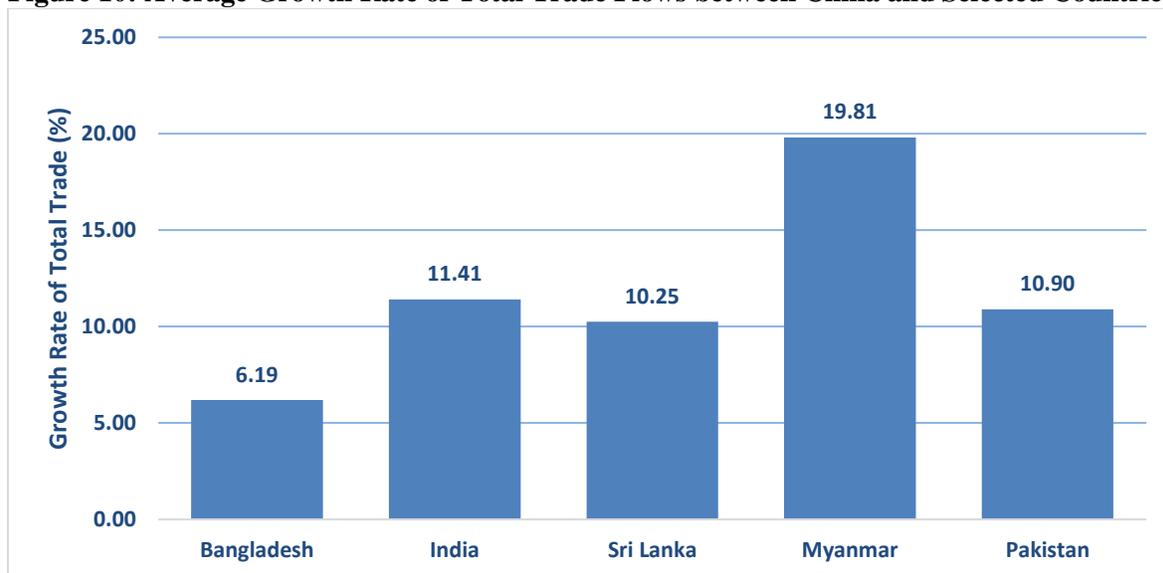
03. Sri Lanka - China Economic Relations in Regional Context, and the Way Forward

03.1. Trade Relations

In Section 02.1, on the development of trade relations, I explained how Sri Lanka - China trade relations have grown over time. However, the analysis should be extended beyond a time-based analysis, in order to observe the strength of Sri Lanka - China trade relations compared to other regional counterparts. Hence this section examines the regional position of Sri Lanka in terms of trade-flows between Sri Lanka and China, compared to other main trading partners of the region.

India has consistently been the main South Asian trading partner of China, followed by Bangladesh. Figure 10 illustrates the average growth rate of total trade flows in 1998-2010, between China and its main trading partners in Sri Lanka's neighboring region. According to the graphical analysis, trade flows between Myanmar and China have grown rapidly – at approximately 20% in the period 1998-2010, followed by India, whose trade flows with China increased by 11.41% on average, per annum.

Figure 10: Average Growth Rate of Total Trade Flows between China and Selected Countries



Source: Created by author based on the data from the World Integrated Trade Solution.

The trade flow dynamics of Sri Lanka with China compares favorably to other South Asian countries, and total trade between Sri Lanka and China has grown at 10.25% during the period 1998-2010. Sri Lanka's trade growth with China is higher than that of Bangladesh (6.19%), despite the fact that trade volume from Bangladesh to China is significantly higher compared to the volume of Sri Lanka – China trade. The key reason behind the sound growth rate of trade flows between Sri Lanka and China would appear to be the recently strengthened trade relations between the two countries.

Table 08 summarizes the main global trading partners of China, along with its principal Asian trading partners. Further, Table 08 indicates each trading partner's respective share of total trade with China, and the number of tariff agreements it has with China.

Table 08: China's Main Global Trading Partners and Asian Trading Partners (in 2015)

Partner Name	China's Importing Source Countries		China's Exporting Destinations		Number of Tariff Agreements
	US\$ (000)	Partner Share (%)	(US\$ 000)	Partner Share (%)	
South Korea	174563829.9	10.38	101474642.1	4.45	1
United States	150543984.0	8.95	410804879.6	18	0
Japan	143092948.9	8.51	135896918.5	5.96	0
Thailand	37221137.65	2.21	38310626.47	1.68	1
Singapore	27557899.98	1.64	53139141.3	2.33	2
Indonesia	19814522.49	1.18	34375283.86	1.51	1
UK	18925748.46	1.13	59667967.05	2.61	0
India	13395984.9	0.8	58262003.92	2.55	1
Laos	1316053.43	0.08	1212287.01	0.05	4
Bangladesh	803718.25	0.05	13904754.25	0.61	3
Sri Lanka	259235.21	0.02	4308107.46	0.19	1
Afghanistan	11996.21	0	364318.89	0.02	1
Bhutan	350.07	0	9949.05	0	0
Maldives	193.28	0	172590.28	0.01	0
Myanmar	5301349.07	0.32	9429575.49	0.41	3
Nepal	22988.27	0	830006.49	0.04	1
Pakistan	2477065.83	0.15	16481153.25	0.72	1

Source: Created by author, based on the data from the World Integrated Trade Solution.

As indicated in Table 08, the United States is China's top export destination. The US imported approximately US\$ 410.8 billion worth of goods and services from China in 2015, accounting for 18% of China's total exports. The second top destination for China's exports is its special administrative region, Hong Kong, which imported US\$ 334.3 billion in 2015, and accounted for 14.6% of China's total exports. In addition to the key exporting destinations of the U.S. and Hong Kong, China has fast-growing new export destinations – including Djibouti, Ethiopia and Senegal, whose imports from China have increased by 290.3%, 289.2% and 222.6%, respectively.

With regard to China's imports, South Korea was the top import source country for China in 2015, followed by the United States. China's imports from South Korea accounted for US\$ 174.6 billion in 2015, while the United States exported US\$ 150.5 billion worth of goods and services to China. These two countries jointly account for approximately 20% of China's total imports. In addition, Asian countries such as Japan, Thailand, Singapore and Indonesia are also key import source countries of China. In particular, Japan and Thailand supplied 8.51% and 2.21% of China's total imports in 2015.

Sri Lanka – China Trade Relations in a South Asian context

By contrast to East and Southeast Asian countries, the shares of South Asian countries of China's total imports are below 1%, with the shares of India and Myanmar accounting for 0.8% and 0.32% respectively. Sri Lanka's exports were sufficient to constitute only 0.02% of China's total imports in 2015. The contributions of other South Asian countries such as Afghanistan, Bhutan, Nepal and Maldives were almost zero in the same year. With regard to their share of China's total exports, India is the top exporting destination of China in the South Asian region. 2.55% of the total exports of China were imported by India in 2015, while Sri Lanka imported only 0.19% of China's total exports.

The given analysis indicates that Sri Lanka's trade performance with China is marginally better compared to some other South Asian countries such as Afghanistan, Bhutan, Nepal and Maldives. However, trade flows between the two countries have caused a severe trade deficit in Sri Lanka due to Sri Lanka's weakened export base. Consequently, Sri Lanka's future trade prospects with China should focus more on export-oriented trade relations. In fact, Sri Lanka has now recognized 566 products in which Sri Lanka has comparative advantages, and 24 products on the list are domestically produced by China. However, 299 products on the list are *not* currently exported to China. Sri Lanka therefore has great potential to increase its exporting capacity by introducing these new products to the Chinese market.

Table 09 highlights a few of these potential products that can be exported to China, under no or low tariff rates.

Table 09: Potential New Export Products to China

Products	Sri Lanka's export to the world 2012 (US\$, 000)	Annual growth in value of total exports to China (2008-2012)	Tariff rate applied to Sri Lanka in China
Printed circuits	26486	10%	0%
Parts of electronic integrated circuits and micro assembles	4222	-8%	0%
Chemical/allied industry preparations	1071	22%	0%
Manioc (Cassava), fresh or dried, whether or not sliced or pelleted	1389	42%	8.3%
Banana including plantains, fresh or dried	5692	32%	6.9%
Footwear, outer soles of rubber/plastic uppers of leather	3628	18%	8.5%

Source: Export Development Board, Sri Lanka (2014)

All of the products listed in Table 09 are currently being produced in Sri Lanka and exported to countries *other than* China. Therefore, Sri Lanka government representatives only need to negotiate with possible buyers of these goods in China and introduce these products into Chinese markets. In fact, the first three products – printed circuits, a part of electronic integrated circuits, and micro assembles and chemical/allied industry preparations, can be exported to China at a zero tariff rate. Similarly, according to Table 09, there is a growing demand in China for products such as Manioc, Banana, Chemicals, and Footwear and Leather products. Although these products are being exported to China by other countries, there is potential for Sri Lanka to penetrate the Chinese markets due to growing demand in China, and also due to the low tariff rates applied. However, for long-term benefits, it is necessary and therefore highly recommended that Sri Lanka and China negotiate a free trade agreement between the two countries, which can be of mutual benefit.

03.2. Investment Relations

Section 02.2 above explains how Sri Lanka - China investment relations have grown over time. However, it is still unclear whether we have reached potential levels of investment from China, when compared to Sri Lanka's regional counterparts. This section examines the relative importance of Chinese investments in Sri Lanka, comparing it to the extent of Chinese investment received by neighbouring countries.

Being the world's second largest economy and a rising superpower of Asia, China has rapidly increased their outflow of Foreign Direct Investment (FDI) during the last decade. According to the OECD (2014), China invested US\$ 107 billion in 2013, making it the third largest foreign direct investor the world, just behind the United States (US\$ 336 billion) and Japan (US\$ 136 billion), who were the first and second largest, respectively.

Chinese FDI to Asia

According to the Ministry of Commerce of the People's Republic of China, 68% (US\$ 447.41 billion) of the total FDI of China in 2013 were invested in Asian countries, followed by 13% (US\$ 86.09 billion) in Latin America. The geographical proximity of Asian countries to China, alongside relatively high regional integration in the Asian region, are key reasons for Asian countries to seek and receive a large amount of Chinese FDI compared to countries in other regions. Table 10 indicates Asia's top ten recipients of Chinese Outbound Foreign Direct Investments in 2013.

Table 10: Top 10 Recipients of Chinese Foreign Direct Investments in Asia in 2013

Country	Flow of Chinese FDI (US\$, billion)	Stocks of Chinese FDI (US\$, billion)
Hong Kong	62.82	377.09
Singapore	2.03	14.75
Indonesia	1.56	4.66
Kazakhstan	0.81	6.96
Laos, PDR	0.78	2.77
Thailand	0.76	2.47
Iran	0.75	2.85
Malaysia	0.62	1.02
Cambodia	0.5	2.85
Vietnam	0.48	2.17

Source: Created by author based on the data of Herrero et al, 2015

According to Table 10, it is clear that a majority of Chinese FDI is directed at ASEAN and East Asian countries. Hong Kong is the top Chinese FDI recipient destination, having secured US\$ 62.82 billion in FDI from mainland China, while the stocks of Chinese FDI (Cumulative Chinese FDI till 2014) is equal to US\$ 377.09 billion by 2013. The stocks and flow of Chinese FDI received by the other nine countries is substantially lower than that of Hong Kong, presumably owing to the latter's status as a special administrative region of China. For instance, Singapore received only US\$ 2.03 billion of Chinese FDI, while the stock of Chinese FDI was US\$ 14.75 billion.

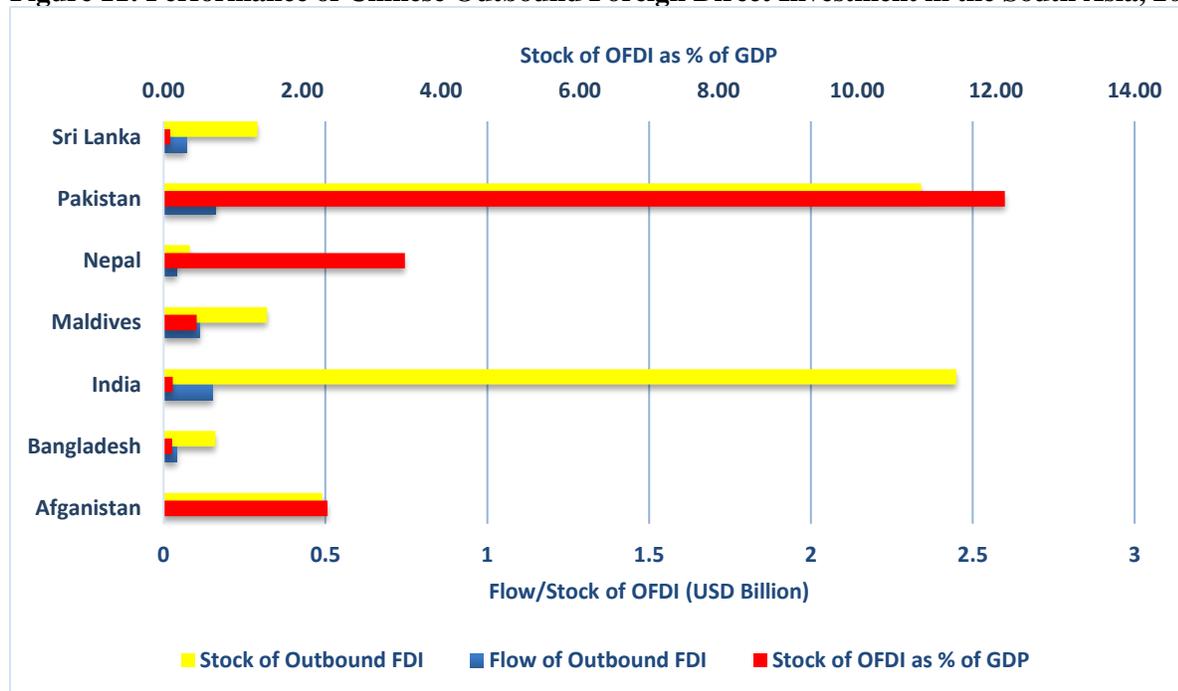
Chinese FDI to South Asia

The most critical fact highlighted by Table 10 is that there are no South Asian countries among Asia's Top 10 recipients of Chinese OFDI. Figure 11 below compares the amount of stock and flow of Chinese OFDI received by South Asian countries. In addition, the figure indicates the amount of Chinese OFDI stock owned by each country as a percentage of its GDP.

As figure 11 depicts, India and Pakistan have by far the largest stock of Chinese OFDI, being the first and second largest owners of Chinese OFDI stocks respectively. However, Pakistan's OFDI stock was equal to 12.13% of its GDP, while India's was just 0.13% of its GDP. Similarly, by 2013, Nepal and Afghanistan also had Chinese OFDI stocks equal to 3.48% and 2.36% of their GDP respectively. In contrast, Chinese OFDI stocks owned by Sri Lanka amounted to US\$ 0.29 billion by 2013, only above the stocks of Nepal and Bangladesh.

Furthermore, the stocks owned by Sri Lanka are just 0.10% of its GDP – the *least* among the South Asian counterparts. Despite this, China is the current top FDI donor of Sri Lanka, accounting for 25% of the total FDI inflows of Sri Lanka. It is apparent, therefore, that notwithstanding the increasing trend of Chinese OFDI in Sri Lanka, Chinese OFDI as a percentage of GDP remains low compared to other South Asian countries.

Figure 11: Performance of Chinese Outbound Foreign Direct Investment in the South Asia, 2013



Source: Created by author based on the data of Herrero *et al*, 2015

The Asian Infrastructure Investment Bank (AIIB)

FDI brings many economic benefits such as employment opportunities, technological transfers, and better access to market along with higher economic growth. Hence, developing countries like Sri Lanka need considerable amount of FDI, especially from industrialized countries like China, in order to stimulate lagging industrial sectors and to develop its infrastructure base. Although current Chinese OFDI is not

sufficient as a percentage of GDP, there is greater potential of attracting more FDI and securing grants and loans to develop the infrastructure base through the newly-established Asian Infrastructure Investment Bank (AIIB).

Sri Lanka is a founding member of China-led AIIB, which is expected to provide infrastructure-oriented loans with fewer pre-conditions than their more Western counterparts. AIIB has already indicated interest in providing a US\$ 1 billion loan to Sri Lanka for infrastructure development. In any event, it is vital that Sri Lanka should maintain an investor-friendly atmosphere in order to attract high quality, large-scale investments. Specifically, modern infrastructure facilities and an established and transparent legal system are essential to attract FDI. Indeed, the current Chinese Ambassador to Sri Lanka, Yi Xianliang, has recently highlighted that existing legal framework of Sri Lanka is not so investor-friendly, especially for mega-infrastructure projects (Financial Times, 2016).

It is important to re-think the legal framework for foreign investment agreements, including aspects such as speed of the judicial process, representation by foreign law firms, and international arbitration. Sri Lanka should aim for a higher rank in the *Ease of Doing Business Index*. Its rank was 85 in 2013 but by 2015, had dropped to 113, by 22 ranks. Despite a slightly improved rank from 113 in 2015 to 107 by 2016, the changes are insufficient to win the confidence of investors. Consequently, urgent attention should be paid to the various dimensions of the ease of doing business, in order to encourage and maintain a sufficient level of investments. As a practical matter, it would also help if the process for obtaining Chinese business visas is simplified from the Chinese side, to allow Sri Lanka's business community to attend investment-related conference and trade exhibitions more conveniently.

03.3. Tourism Relations

With a rising middle class, China's outbound tourism market has grown exponentially. An expanded network of international flights, more convenient travel and visa procedures for Chinese citizens, and summer holiday packages provided by travel agents, are among the factors that have encouraged the growth of Chinese tourists. China is now one of the largest outbound tourism markets in the world. In 2015, it had 120 million outbound tourists travel internationally, spending approximately US\$ 104.5 billion. Sri Lanka has benefited considerably from the expanded outbound tourism of China, given that China is currently the second-highest source of tourist arrivals to Sri Lanka. As depicted in figure 08, Chinese tourists who visited Sri Lanka during 2010-2015 increased by 17.4%.

Chinese tourism: Sri Lanka compared to other destinations

Although Chinese tourist arrivals are now crucial in Sri Lanka's tourist market, it is notable that current Chinese tourist arrivals to Sri Lanka is negligible when compared to other Asian countries. Sri Lanka does not currently even rank among the top 25 tourist destinations of China. According to table 11 below, China's top tourist destinations include Hong Kong, Macau and South Korea, with these three destinations accounting for 41.05%, 25.7% and 4.33% of the total outbound tourism of China respectively, in 2013. The share of Chinese tourist arrivals to Sri Lanka is just 0.06% of the country's total outbound tourists, and it is significantly lower than the number of outbound Chinese tourists to other Asian countries. More specifically, the number of Chinese tourist arrivals to South Korea and Thailand are 78 and 74 times higher, respectively, than that to Sri Lanka, and the Maldives also receives more than 5 times the number of Chinese visitors than Sri Lanka.

Chinese tourism: Sri Lanka compared to Asian countries

Chinese outbound tourists to other Asian countries have also increased significantly in recent years. During the first ten months of 2014, Asian countries such as South Korea, Thailand, Taiwan, Japan, Vietnam, Malaysia and Singapore welcomed approximately 85.42 million Chinese tourists. This is apparent from the data presented in Table 11. The principal factors that have induced Chinese tourists to visit nearby destinations such as Hong Kong, Thailand, South Korea and Japan are short distances and lower travelling cost and relatively less cultural and climatic differences. Nevertheless, Chinese tourist arrivals to Sri Lanka have grown rapidly and in 2013, arrivals increased by 99%, reporting the largest growth rate of Chinese tourist arrivals across the regions. It is a positive signal for Sri Lanka, and if the growth rate continues, there is a higher possibility of increasing Sri Lanka's share of Chinese outbound tourism.

Table 11: Chinese Outbound Tourism in 2013

Rank	Destination	Number of Chinese Mainland Tourists	Share of Chinese Tourists per Destination	Growth (%) (2013)
1	Hong Kong	40303300	41.05	15.3
2	Macau	25239400	25.70	17.4
3	South Korea	4253400	4.33	42
4	Thailand	4010300	4.08	78.7
5	Taiwan	2918900	2.97	11
7	Japan	1834600	1.87	-6.5
8	Vietnam	1772700	1.81	32.3
9	Cambodia	1690600	1.72	-8.4
10	Malaysia	1351600	1.38	-1.5
11	Singapore	1322800	1.35	13.4
13	Russia	915300	0.93	5.3
14	Indonesia	879200	0.90	23.2
16	Myanmar	561300	0.57	2.8
23	Maldives	302400	0.31	45.1
N/A	Sri Lanka	54288	0.06	99

Source: Created by author based on the data from the Sri Lanka Tourism Development Authority and www.travelchinaguide.com

With the prevailing peaceful environment in Sri Lanka, it would be an opportune time to implement appropriate policies to attract more Chinese tourists. Most Chinese tourists prefer destinations where they can use their own language, and they face language difficulties during their travels to South Asian countries. It is therefore essential to have more Chinese-speaking guides and hotel staff.

Similarly, most Chinese tourists use internet based online e-tourism sites such as *Tuniu*, *Baidu* and *Sina* to search for their preferred destinations. It is thereby necessary to promote Sri Lanka's tourism destinations, hotels, and other tourism-related information through these search engines. At the same time, Sri Lankan travel websites should be highly ranked on these sites to attract high-end Chinese tourists.

Sri Lanka already has a more user-friendly visa system for Chinese visitors. The national carrier, "Sri Lankan Airlines," flies three times a week to China, and a few Chinese airlines also fly to Sri Lanka. However, air-connectivity between the two countries should be further improved, to provide more frequent, efficient, and convenient services. Moreover, Chinese credit cards should be accepted in Sri Lanka and there should be proper policies to foster excellent service for their consumption and payment. The prices of goods and services relating to the tourism sector should be determined collectively by the government and

companies involved in the business, after considering both quality and regional price levels (Financial Times, 2015). Given the historically good diplomatic relations between the two countries, the adoption of the above-mentioned recommendations should ensure well-developed tourism relations between the two countries.

04. Conclusion and Recommendations

Relations between Sri Lanka - China have existed for almost over two millenniums. In ancient time, these were mainly religious and cultural, rather than commercial or trade relations. They began with the great traveler monk from China, Fa Xian, who visited Sri Lanka as far back as 411. Sri Lanka and China established formal diplomatic relations in 1957, although their historic Rubber-Rice Pact was initiated 5 years before even this official milestone.

Sri Lanka's strategic location, between major shipping lanes and on the 'String of Pearls' has attracted renewed attention from China in recent years. China-Sri Lanka relations in the 21st century have been enriched by a number of high profile meetings held in both countries, attended by top-level delegates of both countries, and the advancement of economic relations in trade, investment and tourism. The concluding remarks below summarize the analysis of this paper of these three areas and suggest how Sri Lanka – China economic relations may be further enriched with regard to trade, investment and tourism.

Trade

The time-based analysis of this paper shows that trade relations have expanded significantly in the recent past. Currently, China is the second largest source of imports to Sri Lanka, accounting for 19.65% of Sri Lanka's total imports. Although India is the largest importing partner of Sri Lanka, the growth rate of China's imports during the period of 2010-2014 is 175.3%, while imports from India grew at just 56.2% in the same period.

Although China is a key source of Sri Lanka's imports, it is not ranked even among the top 10 export destinations of Sri Lanka. It was the 14th largest export destination of Sri Lanka in 2014. This import-centric trade relation has led to a severe trade deficit for Sri Lanka. This deepening trade deficit currently accounts for 26.4% of Sri Lanka's total trade deficit. Nevertheless, this import-driven trade deficit should not be regarded as entirely unfavorable, as Sri Lanka's major imports from China include raw materials for producing the island's main exports, particularly garments and textiles. Imports from China remain vital for Sri Lanka to expand its textiles industry and to ensure growing demand for its garment products.

The comparative regional analysis in this paper shows that Sri Lanka's trade performance with China is marginally better compared that the performance of some of its neighbors, such as Afghanistan, Bhutan, Nepal and Maldives. Sri Lanka's exports were sufficient to add only 0.02% to the total imports of China in 2015. However, the contributions of other South Asian countries such as Afghanistan, Bhutan, Nepal and Maldives were almost zero. Looking at Chinese exports to the region, India is by far the largest receiving destination, accounting for 2.55% of the total exports of China, while Sri Lanka imported only 0.19% of China's total exports.

There is potential for Sri Lanka to improve its export performance and slightly narrow its trade deficit with China. Sri Lanka has now identified new export products such as printed circuits, a part of electronic integrated circuits, micro assembles and chemical/allied industry preparations, which can be exported to

China at a zero tariff rate. Similarly, there is a growing demand in China for products such as manioc, banana, chemicals, footwear and leather products.

Investment

Further to the concept of a “String of Pearls,” China has tried to build a closer strategic relationship with Sri Lanka by facilitating major investment projects, which it has supported to a far greater extent than any other country. By 2014, China had become the largest FDI donor to Sri Lanka, followed by the UK, accounting for the largest share (24.53%) of the total FDI inflows of Sri Lanka. Similarly, FDI inflows from China have grown by 117.84% during the period of 2011-2014. Chinese FDIs in Sri Lanka have largely been directed to the telecommunications, garment, power, energy and electronic manufacturing sectors.

Given the increasing limits to obtaining concessional loans and aid from Western multilateral organizations such as IMF and the World Bank, Sri Lanka sought possible financial assistances from China with minimal preconditions. Accordingly, 37.2% of Sri Lanka’s total foreign borrowings in 2010-2014 were from Chinese sources, principally from state-owned or state-affiliated banks in China. Despite the growth of Chinese FDI, however, no South Asian country – including Sri Lanka – features among even the top 10 recipients of Chinese FDI to Asia. Chinese OFDI stocks owned by Sri Lanka amounted to US\$ 0.29 billion in 2013, just above the stocks of Nepal and Bangladesh. Furthermore, the Chinese OFDI stocks owned by Sri Lanka are only 0.10% of the country’s GDP – the least among its South Asian counterparts.

Sri Lanka also now has greater potential to attract more FDI, and secure grants and loans to develop its infrastructure base, through the newly established Asian Infrastructure Investment Bank (AIIB). Sri Lanka should develop infrastructure facilities and maintain a well-established and transparent legal system, work to improve its ranking on the Ease of Doing Business Index, and China should ease the process for obtaining business visas to facilitate investment-seeking visits to China.

Tourism

China has clearly emerged as a major tourist partner of Sri Lanka. It became the second-best tourist partner of Sri Lanka in terms of tourist arrivals by 2015, pushing the UK into third position. Although India has alternatively been the top and second-best tourist partner of Sri Lanka in terms of the number of tourist arrivals, a growth rate of Chinese tourist arrivals in recent years indicates the significance and potential further growth of China as a tourism partner of Sri Lanka.

The potential for growth in China - Sri Lanka tourism is underscored by the comparative regional analysis undertaken in this paper. While Chinese tourist arrivals already play a crucial role in Sri Lanka’s tourist market, the number of current Chinese tourist arrivals to Sri Lanka is negligible compared to other Asian countries. Sri Lanka does not currently rank even among the top 25 tourist destinations of China. The share of Chinese tourist arrivals to Sri Lanka is just 0.06% of the country’s total outbound tourists, which is drastically low compared to the number of outbound Chinese tourists to other Asian countries. To attract more Chinese tourists, however, it will be essential to have more Chinese-speaking guides and hotel staff in Sri Lanka, to promote Sri Lankan tourist destinations on online e-tourism sites such as *Tuniu*, *Baidu* and *Sina*, and to have a more user-friendly visa system for Chinese nationals, accept Chinese credit cards, and strengthen air connectivity between the two countries.

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