SPECIAL REPORT

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China's Engagement with Smaller South Asian Countries

By Nilanthi Samaranayake

An operator works as shipping containers are seen in the background at the main port in Colombo, Sri Lanka. (Photo by Dinuka Liyanawatte/Reuters)

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Summary

- The smaller South Asian (SSA) countries maintain different levels of interaction with China, ranging from Bhutan, which has no formal diplomatic relations with China, to Bangladesh and Sri Lanka, which have the strongest military and economic ties, respectively.
- On balance, SSA countries have benefited from China's growing economic and military engagement with them and the region. Chinese projects have helped increase connectivity within these countries as well as with external trading networks.
- Despite China's arms sales to these countries, the dominant role exerted by India in South Asia and difficulties in the India-China relationship have ensured that military ties of SSA countries with China remain limited.
- SSA countries are increasingly aware of the potentially negative impacts and unintended consequences of Chinese financing of development projects, and they are weighing the economic benefits of such projects against the potential strategic costs of future Chinese involvement.
- US concerns about how Chinese loans to SSA countries are affecting regional security dynamics should prompt Washington to help alleviate the challenging structural conditions these countries face in the prevailing development finance order.
- SSA countries will have continuing relevance for US interests across the Indo-Pacific region, including their reliance on China for development finance, India's standing in the region, domestic politics and internal conflict dynamics, and regional security.

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ABOUT THE REPORT

This report examines the changing relationships of Bangladesh, Bhutan, Maldives, Nepal, and Sri Lanka with China and the implications for US security interests in South Asia. Supported by the Asia Center at the US Institute of Peace, this study was based on data sources from the five countries as well as fieldwork in Dhaka, Bangladesh; Kathmandu, Nepal; and Colombo and Hambantota, Sri Lanka.

ABOUT THE AUTHOR

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Making Peace Possible

China's Foreign Minister Wang Yi delivers a speech at an international forum on the Belt and Road Initiative in Beijing, on July 2, 2018. (Photo by Jason Lee/Reuters)

Introduction

China's increasing engagement with the smaller countries in South Asia has drawn scrutiny from policymakers and strategists concerned with the implications of China's rise for the existing regional order. In particular, since the early 2000s, Indian and US analysts have expressed concerns that Chinese partnerships with countries such as Bangladesh, Pakistan, and Sri Lanka could be aimed at establishing a "string of pearls" of military bases that would encircle India and expand China's overseas presence. More recently, concerns have emerged that Chinese lending under the Belt and Road Initiative (BRI) could ensnare participating countries by saddling them with so much debt that they cede their sovereign rights to China in exchange for use of their infrastructure or territory. Commentators have labeled this concept "China's debt trap diplomacy."[1]

Deeper analysis of Chinese ties with the smaller countries of South Asia—specifically Bangladesh, Bhutan, Maldives, Nepal, and Sri Lanka (collectively, the smaller South Asian, or SSA, countries)—suggests that the reality of these relationships is much more complicated. The SSA countries are each at different stages in their interactions with China and are learning from one another's experiences. All retain agency in their relationships with China and other major powers, even as domestic political factors heavily shape their engagements with these countries. Although the SSA states have an insatiable appetite for connectivity and infrastructure projects as they seek to advance their own economic development, they generally view China as a fallback option and not necessarily a partner of first choice. The leaders of SSA countries largely still see India as the dominant power in South Asia, suggesting that Chinese economic activity, while welcome, will not necessarily translate into major military or strategic gains.

This report aims to provide deeper insight into the smaller countries of South Asia and their evolving engagement with China. Although it identifies the clear risks posed by China, it cautions against extrapolating too much from current levels of cooperation. Instead, it recommends a more comprehensive US approach to address structural challenges faced by SSA countries that affect their political and economic decision making with regard to China. The report draws on fieldwork conducted between March and July 2018 in Dhaka, Bangladesh; Kathmandu, Nepal; and Colombo and Hambantota, Sri Lanka, as well as in-depth interviews with government officials, academics, think tank experts, and journalists, in order to illuminate the countries' national priorities and views on China's potential role in helping achieve them.

Shifting Patterns of Economic and Military Cooperation

China's economic ties with SSA countries are increasing through trade in general and infrastructure projects in particular, though the breadth and depth of these ties vary greatly by country. By contrast, China's military ties with most of these countries are nascent and dwarfed by their activities with India and even the United States.

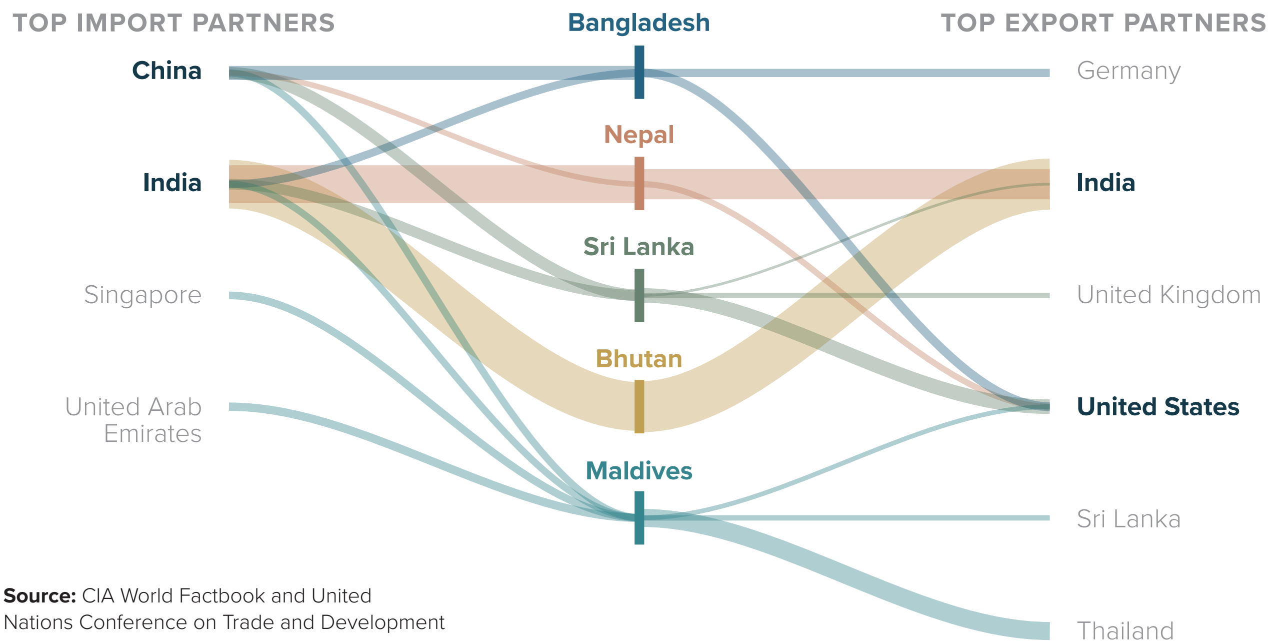
In terms of overall economic cooperation, relations with China are growing in four of the five SSA countries. With respect to trade, China is notably not a top export destination. The United States, rather, is the top export partner for Bangladesh and Sri Lanka, second for Nepal, and third for Maldives (see figure 1). Yet even though SSA countries are eager to export to the United States, China is one of the top sources of imports for these countries—the largest for Bangladesh and Sri Lanka, the second largest for Nepal, and the third largest for Maldives. Moreover, in 2017, after more than two years of negotiations, Maldives became the first SSA country to sign a free trade agreement with China.

China's penetration into the economic life of SSA countries is deepest in terms of cooperation on development. Nevertheless, its economic interests in South Asia do not appear to be as great as in other regions, such as Africa (where it is able to extract resources) or the Middle East (where it has deep energy interests). Analysis by the Center for Global Development shows that two of the five SSA countries, Maldives and Sri Lanka, are vulnerable to debt distress under the BRI. Maldives is considered highly vulnerable to debt distress, while Sri Lanka is significantly vulnerable. Bangladesh and Nepal, by contrast, have low risk for debt distress in general, including under the BRI, while Bhutan is significantly vulnerable but is not a BRI recipient.[2]

Regarding military cooperation, SSA countries' ties with China are limited. Defense officials from Beijing travel to these countries, and ships from the People's Liberation Army (PLA) Navy have visited ports on goodwill or refueling stops. With the exception of Bangladesh, however, they all have strong military ties with India, and all five must take into account New Delhi's strategic preferences regarding China in their foreign policy decisions. As a result, none engages in regular exercises with China.

FIGURE 1. TOP TRADE PARTNERS FOR SSA COUNTRIES (2016)

China is the largest source of imports for Bangladesh and Sri Lanka, the second largest for Nepal, and the third largest for Maldives, but it is notably not a top market for the SSA countries' exports. Lines are proportional to the percentage of imports (exports) from (to) the trade partner.



Source: CIA World Factbook and United Nations Conference on Trade and Development

SRI LANKA

Of all the SSA countries, Sri Lanka's relations with China have received the most attention in recent years. By 2005, China had become the top provider of development commitments to Sri Lanka, and by 2010 it overtook Japan in development disbursements.[3] China has maintained this top status to the present day.[4] The proportion of Sri Lanka's debt owed to China is often exaggerated, and the terms of Sri Lanka's contracts with China vary by project, and include both loans and foreign direct investment (FDI).

Economic ties

Sri Lanka's economic relations with China increased under the administration of President Mahinda Rajapaksa (2005–15) and have continued to grow during the current administration of President Maithripala Sirisena. Regarding trade, China has become Sri Lanka's second-largest source for imports after India.[5] More important for the Sri Lankan economy, China has become the country's sixth-largest export destination, though the United States remains Sri Lanka's top exporting trade partner.

China, India, the Netherlands, and Singapore are the top sources of FDI in Sri Lanka.[6] Notably, the Chinese-built Port City project in Colombo, at a cost of roughly $1 billion, is the largest infusion of FDI that Sri Lanka has received. FDI is also funding a planned liquefied natural gas power plant to be built in Hambantota. Sri Lankan officials affirm the need for such investment because the country's exports are lagging and its trade deficit has been widening.[7] FDI inflows boost foreign reserves and allow Sri Lanka to repay its loans, mostly in US dollars.[8]

Even though experts have criticized the Hambantota projects for their poor implementation, Sri Lanka's leaders sought to invest in this underdeveloped region in the context of the country's experience with insurgency, natural disaster, and an overarching postconflict ambition.

Beyond FDI, in 2017 China provided the largest amount of loans to Sri Lanka for infrastructure projects (21.5 percent), followed by Japan, the World Bank, and the Asian Development Bank (ADB).[9] Yet when examining China's significant role in these development projects, it is important to put Sri Lanka's overall debt and *debt specific to China* into context. First, the country's debt-to-GDP ratio is 77.6 percent. Of this proportion, more than half of the government's debt is held domestically (42.1 percent vs. 35.5 percent foreign).[10] Second, Sri Lankan government data estimates roughly $9.2 billion in Chinese commitments to the country from 2001 to 2017.[11] Of this committed amount, 61 percent ($5.6 billion) has been concessional financing, whereas 39 percent ($3.6 billion) has been through commercial loans.[12] The Center for Global Development estimates that Sri Lanka's current debt owed to China stands at $3.85 billion.[13] Calculated as a percentage of total debt listed ($69.286 billion), Sri Lanka's debt to China is 5.5 percent of the country's total debt.[14] In other words, 94.5 percent of Sri Lanka's debt is *not* to China. When narrowing the scope to external debt listed ($32.565 billion), this proportion rises to 12 percent.[15] Thus, while Sri Lanka's debt to China is significant, its debt problems go far beyond any one country.

The most high-profile infrastructure project that the previous Sri Lankan government pursued with Chinese loans is the Hambantota port development project. Although the agreement was reached by then President Rajapaksa, whose home district is Hambantota, efforts to build infrastructure here predated his presidency, and the multiple drivers of the project are not well understood. To begin with, for decades Hambantota had been discussed as a potential port location because of its close proximity to sea lanes and convenience for refueling. During negotiations in 2005—including a trip to China—President Chandrika Kumaratunga requested financing for a bunkering system and tank farm project.[16] A second important catalyst for this effort was the need to rebuild Hambantota after the devastating Indian Ocean tsunami of 2004. Yet even with these pragmatic considerations, a third fundamental driver for the port project was Sri Lanka's domestic stability and security. Hambantota, an arid, salt-producing region of the southern part of the island, has been underdeveloped and was a source of discontent during the Janatha Vimukthi Peramuna (People's Liberation Front, or JVP) insurgency in the wider Southern Province in the 1980s. Even a minister under the new government that defeated President Rajapaksa has asserted that the Hambantota port project "will usher economic transformation in the country, especially in the Southern and Uva provinces."[17] Thus, even though development planning experts have rightly criticized the Hambantota infrastructure projects for their poor implementation, Sri Lanka's leaders sought to invest in this underdeveloped region in the context of the country's experience with insurgency, natural disaster, and an overarching postconflict ambition to position Sri Lankan ports as regional and global trade hubs within Asia and to East Africa.[18]

The $1.2 billion Hambantota project has garnered the majority of attention in discussions of Chinese loans to Sri Lanka, but the country's infrastructure development needs are much broader and extend to water and sanitation, ground transportation, road and bridge

MAP OF THE SMALLER SOUTH ASIAN COUNTRIES

Adapted from artwork by Rainer Lesniewski/Shutterstock

construction, and irrigation. In fact, beyond the well-known port project, most (twenty-five of forty-one) of China's loans to Sri Lanka from 2008 to 2018 were for road and railway projects.[19] Totaling $4.2 billion, these projects include the country's first highways connecting Colombo to the airport and to southern cities (Galle and Matara, and eventually Hambantota).

Most of Sri Lanka's development funds come in the form of loans rather than grants. Rising per capita income has enabled Sri Lanka to transition to a lower middle-income country, and as a result it is no longer eligible to receive as much concessional assistance.[20] According to Sri Lanka's Department of External Resources, "In 2017, both ADB and World Bank, the leading multilateral development partners of Sri Lanka have officially announced the formal graduation of Sri Lanka from eligibility to access concessional resources from them."[21] To adjust to this more challenging climate of obtaining financing for infrastructure projects, Sri Lanka sought commercial loans and sovereign bonds at commercial interest rates and shorter repayment schedules.[22]

The Hambantota case highlights the challenges confronting countries transitioning to middle-income status. With concessional financing no longer available, and with World Bank and ADB loans requiring a faster repayment schedule, the current government leased the port for ninety-nine years to a majority-held Chinese joint venture in 2017 in exchange for roughly $1 billion in FDI. In Sri Lanka's case, this situation significantly affects the country's cash flow management, where FDI is low and revenue from exports and remittances are not enough to repay loans in US dollars. Transitioning middle-income countries that achieve their next-step income goals, like Sri Lanka, are inadvertently penalized: they continue to have development priorities but have less access to grants and concessional loan terms to finance their infrastructure.

Sri Lanka's response to this circumstance is instructive for other SSA countries. Although the China "debt trap" angle of Sri Lanka's experience is often discussed, aspects of low-income countries' transition to middle-income status are sometimes referred to as the "middle-income trap." In these circumstances, developing countries face difficulties in achieving further levels of growth. This case examines Sri Lanka's economic situation and its security implications illustrated by the ninety-nine-year lease of a port, but four of the five SSA countries also face challenges inherent in the middle-income transition.

Military ties

Military interactions with China remain limited, especially in comparison to Sri Lanka's deep training, exercise, and hardware engagement with India. During the war against the Liberation Tigers of Tamil Eelam (LTTE) insurgency, Sri Lanka relied on China for ammunition—especially after other countries, including India and the United States, banned sales of lethal weapons to Sri Lanka because of human rights concerns—but this relationship has dropped off since the end of the war in 2009. In its postconflict development strategy, Sri Lanka has been positioning itself as a shipping hub in the Indian Ocean. To this end, it has been expanding its naval and maritime capabilities to protect the security of its waters, mainly by relying on India, Japan, Australia, and the United States for matériel and platforms such as ships and radar installations. In fact, the July 2018 announcement by a Chinese defense official of plans to donate a "frigate" to Sri Lanka's navy was a reminder of how much China's defense hardware cooperation had fallen off with Sri Lanka in the preceding decade.[23]

Sri Lanka invites China to its multinational Cormorant Strike exercise, and Sri Lankan military officers receive opportunities for education in China. The two armies held Exercise Silk Route in 2015, but the exercise does not appear to have been repeated. The two navies engage in joint drills or passage exercises during PLA Navy visits for humanitarian assistance or refueling midway to the multinational counterpiracy mission in the western Indian Ocean. In 2014, a Chinese submarine visited the port of Colombo on the way to and from a counterpiracy deployment. This was the first-ever port visit by a Chinese submarine in the Indian Ocean, but it was not a military-to-military interaction. Due to the resulting controversy, Sri Lanka has since resisted permitting another visit by a Chinese submarine.[24]

BANGLADESH

Bangladesh is by no means a small country; in terms of population, it is the eighth largest in the world. However, it certainly counts as a "smaller" South Asian country given its asymmetric relationship with India and similarities with other SSA countries.[25] With the exception of the period after gaining independence from Pakistan—China's ally—in 1971, Bangladesh has had positive relations with China for most of its existence. Dhaka's economic and military ties with Beijing continue to increase. Although Sri Lanka has the most entrenched economic ties with China, Bangladesh maintains the strongest military ties.

Economic ties

Because of its social and economic achievements since its independence, development experts often regard Bangladesh as a "success story." It is now a leader in the ready-made garment industry, which produces a substantial majority of the country's exports.

China is the top source of imports for Bangladesh and accounts for roughly a quarter of these goods. The United States, however, remains Bangladesh's top exporting destination, fueling the country's economy. Regarding FDI, Bangladesh has received investment from a variety of partners, including China. From 2008 to 2014, Egypt, Singapore, and Malaysia were its top three partners. Investment from Hong Kong (China) ranked fourth, while mainland Chinese investment ranked tenth. Combined investment from Hong Kong and mainland China, however, ranks third ($601.6 million) after Egypt and Singapore during this period. Beyond investment cooperation, Bangladesh has sought grants and loans from a number of partners to build and enhance its infrastructure. Notably, total grant and

Bangladesh's Prime Minister Sheikh Hasina shakes hands with Chinese President Xi Jinping at the Great Hall of the People in Beijing on June 10, 2014. (Photo by Wang Zhao/Reuters)

loan flows from 2007 to 2014 were mostly from India, followed by Russia and China. China provided $358.4 million, in the form of $217.7 million in grants and $140.7 million in loans. Bangladesh characterizes its development cooperation with China as mostly "aid in [the] form of projects in-kind, government concessional loans, preferential buyer's credit, technical cooperation and scholarships."[26]

Bangladesh's economic cooperation with China appears set to intensify under the BRI. As the first Chinese head of state to visit Bangladesh since 1986, President Xi Jinping offered $24 billion for twenty-seven development projects in October 2016. The hefty promises during the visit have yet to come to fruition, however: the latest commitment data from Bangladesh's Economic Relations Division shows only three projects were signed during Xi's visit, totaling roughly $1.2 billion.[27] At present, Bangladesh is engaged in negotiations with China about the loan terms for other projects under BRI.[28] These projects reflect its need for better access to power, as well as infrastructure and information and communications technology.

Dhaka has learned from the international discussion about China's "debt trap" as well as from the experience of other SSA countries, especially Sri Lanka. This suggests that debt—and specifically debt to China—may not become the problem that it is elsewhere. Indeed, Bangladesh is one of only two SSA countries that are not listed as being vulnerable to debt distress in the report by the Center for Global Development.[29] Nonetheless, Bangladesh may no longer receive the same advantageous lending opportunities it benefited from in the past. In 2015, it transitioned from a "low income" country to a "lower middle-income" one, according to the World Bank, and it recently met United Nations criteria to graduate from a "least developed country" to a "developing country" by 2024.

Although this trend is certainly positive, the international financial environment will become increasingly difficult for Bangladesh, even as its economy continues to grow. Much as Maldives and Sri Lanka found during their own economic advancements, the improved economic conditions for countries that have reached middle-income status trigger the withdrawal of concessional assistance. Governments accustomed to these inflows from international development banks are thus tempted to seek loans elsewhere, such as from China, and sometimes at higher interest rates. In fact, Bangladesh acknowledges that its external debt as a share of GDP has nearly doubled since 2009 and that it will need to be vigilant in its approach to debt management.[30] Its policymakers are mindful of Sri Lanka's experience as they consider the potential impact of China's BRI investments.

Military ties

Because of historical challenges, Bangladesh's bilateral relationship with India has not included much defense cooperation. By contrast, China has been a willing partner in this realm and for many years has been Bangladesh's top supplier of military equipment. A review of data compiled by the Stockholm International Peace Research Institute shows Bangladesh has procured a significant number of military platforms and capabilities from China in the past two decades—considerably more than any other SSA country.[31] In addition, China provides military weapons at a lower price than other suppliers. Bangladesh achieved a milestone in 2016–17 by acquiring two Ming-class submarines from China. Though the Ming-class submarine is an old platform, it is useful for a country learning how to operate submarines.[32] Bangladesh's ability to buy these vessels reflects Beijing's willingness to make expensive platforms normally associated with high-end militaries affordable to developing countries.

NEPAL

Considered low-income by the World Bank, Nepal is the poorest of the five SSA countries. Following a ten-year civil war that ended in 2006, it is in a transitional period, having developed a constitution and continued to work to reshape its political system. Although geographically Nepal is sandwiched between India and China, its biggest challenge is not geopolitical. Low employment at home has caused Nepalis to migrate to the Middle East in search of jobs.[33] Moreover, lingering postconflict issues and political instability—Nepal has seen twenty changes in government in two decades—have hampered efforts to reform the economy.

To understand the context for Nepal's current relationship with China, it is critical to understand its relationship with India. India is Nepal's top economic and military partner, but the relationship has grown increasingly strained following what is viewed as India's "unofficial blockade" of fuel and vital goods in the aftermath of a devastating earthquake in 2015.[34] Regardless of culpability, the incident compelled Nepali policymakers to become serious about seeking alternative trade routes through the 2016 trade and transit agreement with China.[35] This episode typifies Nepal's view of China as an option that offers possibilities beyond India, but one to which Kathmandu does not wish to become equally beholden.

Economic ties

Nepalis emphasize the increased numbers of Chinese business people and tourists in Nepal, and the number of direct flights between the two countries.[36] Nepal's top trading partner (imports and exports) is still India, followed by the United States. Annual data from 2012 to 2017 show that the trade balance between Nepal and China is overwhelmingly in China's favor, although Nepal also has a trade deficit with India.[37]

Regarding investment in Nepal, India has been the top investing country through 2015–16. China (Mainland and Hong Kong) was second, totaling $517 million.[38] Based on available Nepali government data, China appears to provide mostly grants and FDI—more so than the middle-income countries Bangladesh, Sri Lanka, and Maldives, where loans are more common.[39] Chinese investment in Nepal is mainly focused on the transportation, tourism, and energy sectors, including the sixteen-kilometer Syaprubesi-Rasuwagadhi road project to improve trade and tourism between China and Nepal.

In terms of loans, China is listed as providing a $156 million loan for the Pokhara airport project, which will be Nepal's second international airport, and a $55 million loan for general economic and technical cooperation.[40] Yet all of these figures are dwarfed by the favorable terms of China's postdisaster reconstruction commitment to Nepal. India tops the list of donors at $1 billion, with $750 million in loans and $250 million in grants. China, however, is second on the list of donors at roughly $767 million—and the entire amount is listed as a grant.[41] Compared with Chinese funding to other SSA countries, this is a significant amount for China to provide as a grant. The Center for Global Development does not consider the country to be at risk for debt problems, echoing findings from the International Monetary Fund and the World Bank.[42] China does not appear as having provided a loan or grant commitment to Nepal in 2017–18.[43]

As a landlocked country, Nepal values projects with China that emphasize establishing or enhancing connectivity. In May 2017, Nepal signed a memorandum of understanding (MOU) with China on road and railway connectivity. For years, Nepalis have hoped for a railway that would connect their country to both China and India. In June 2018, Prime Minister K. P. Sharma Oli made a state visit to China and signed multiple agreements on BRI cooperation, including an MOU on railway connectivity between Kathmandu and the Tibetan border point of Kerung. However, there are some indications that Nepal may be backtracking on some projects out of deference to India. Kathmandu-based journalist Kamal Dev Bhattarai notes that the current government has dropped the plan to connect the railway to Lumbini as a result of pressure from New Delhi.[44] Nepal sees Lumbini as a destination that will attract Chinese tourists and religious pilgrims, with much-needed benefit to the Nepalese economy.[45] At present, the Chinese government is waiting for Nepal to provide it with a list of projects under the BRI.[46] However, Oli's government has requested, as recently as July 2018, the speedy implementation of the trade and transit agreement, specifically for access to China's seaports.

Military ties

Nepal's military-to-military relations with China are among the least developed of the SSA countries and are much less developed than those with India and the United States. Chinese military aid to Nepal is still limited. In early 2017, a general from the PLA's western command visited Nepal, as did China's defense minister and State Councillor Chang Wanquan, with the latter promising roughly $47 million in aid to Nepal's military. In 2017, China completed the $33 million National Armed Police Force Academy for Nepal's paramilitary Armed Police Force.

Yet it was not until April 2017 that the Nepalese army held its first military exercise with the PLA. Sagarmatha Friendship-2017 took place over ten days and focused on counterterrorism and counterinsurgency tactics learned by special forces. A retired Nepali military officer characterized the event as "a very small exercise," summarizing the interaction as Nepal engaging in standard "defense diplomacy."[47] When asked about this development in military relations with China, nonmilitary experts also echoed this sentiment by emphasizing that the Nepalese military's most important partners are India and the United States.[48] For example, about 44,000 Nepali citizens serve in the Indian (40,000) and British (3,600) armies as well as the Singapore Police (400).[49] Moreover, the United States conducts regular exercises and trainings with the Nepalese army.

BHUTAN AND MALDIVES

As the smallest SSA countries, Bhutan and Maldives historically have had the strongest relations with India. However, domestic instability in Maldives has raised the prospect that it could drift outside India's orbit—much to the consternation of Indian policymakers, and by extension the United States. Bhutan, however, remains strongly fixed within India's orbit and has only limited ties with China.

Bhutan is a landlocked nation bordered by China on the north and India on the south. Despite Bhutan's proximity to China, the two countries do not have formal diplomatic relations. By contrast, Bhutan hosts an Indian military training presence and conducts more than 90 percent of its trade (imports and exports) with India. Nonetheless, the Doklam Plateau standoff between Indian and Chinese troops in 2017, in a territory claimed by both Bhutan and China, exposed a potential divergence in Bhutan's relations with India. The Bhutanese government's public messaging and démarche to China emphasized the bilateral nature of the dispute, and the lack of evidence that Bhutan requested India's intervention leads some to believe that Thimphu had no choice but to defer to Indian security concerns.[50] There is a precedent for this position; in 1996, Bhutan reportedly rejected a Chinese agreement to resolve their territorial dispute due to India's prerogative on Doklam.[51] China has attempted to improve bilateral relations with Bhutan since the Doklam episode, with Vice Foreign Minister Kong Xuanyu visiting Thimphu and meeting with then Prime Minister Tshering Tobgay in July 2018.

Maldives—an island nation roughly 250 miles from the southern Indian city of Thiruvananthapuram—is currently at a crossroads. In the September 2018 presidential elections, the challenger Ibrahim Solih upset the incumbent President Abdulla Yameen. Yameen's relations with India had become strained as a result of New Delhi's support of former President Mohamed Nasheed, who faced politically motivated persecution from the administration of the day, and the perception that Yameen was too closely tied to Beijing.[52] But even without this irritant in bilateral relations, it is hard to imagine Nasheed forgoing Chinese loans given the development opportunities for Maldives.[53] Indeed, government officials have publicly affirmed their intention to work with China under the new administration.

The Center for Global Development considers Maldives to be one of the eight countries highly vulnerable to debt under China's BRI.[54] Maldives owes $240 million in debt to China, but this amount accounts for only 8.6 percent of the country's total debt ($2.775 billion).[55] This suggests that, like Sri Lanka, Maldives' debt problems go far beyond China, although a significant proportion of its external debt—roughly a quarter (27 percent)—is owed to China. The new Solih administration is currently recalculating the country's total debt to China, so these figures may change with greater transparency of data. Nevertheless, the handful of major Chinese projects in Maldives remain appealing, especially those that advance the tourism industry, given the country's dependence on tourism to fuel the economy. Of all the SSA countries, Maldives is in the highest economic grouping, at upper middle-income status, according to the World Bank.

Thus far, Maldives' military ties with China have been limited, especially compared with the deep defense ties between Maldives and India. The single Chinese platform promised to Maldives National Defence Force, a sea ambulance for medical evacuation, took six years to be delivered, finally arriving in July 2018.[56] Maldives' relations with China are concentrated on a few types of economic projects, including those concluded during Xi Jinping's visit in 2014—a first for a Chinese

The Sinamalé Bridge links the Maldivian atolls of Malé and Hulhulé. The bridge is the largest Chinese-funded project in Maldives to date. (Photo by Tang Lu/Xinhua/Alamy Live News).

head of state—and during President Yameen's visit to China in 2017. Infrastructure projects are focused mainly on road connectivity across islands, tourism, housing, and upgrading the international airport and its runway. Despite accusations by domestic political opposition of Chinese "land grabs," a statement by China's ambassador to Maldives Zhang Lizhong counts the number of tourism-related projects as seven, with none completed.[57] A review of a map created by the Indian think tank Gateway House that identifies the locations of twenty Chinese projects in Maldives reveals that most projects are in Malé Atoll, the adjacent Felidhu Atoll, and Kolhumadulu Atoll to the south.[58] Essentially, they seem to be clustered around the capital of the country and not in the outer islands.

Lessons Learned and Security Implications for the Region

China has gradually increased its projects in SSA countries and ostensibly will continue to do so under the BRI framework. Several lessons can be drawn from China's engagement with these countries to date.

1. SSA countries are each at different stages in their interactions with China and are learning from one another's experiences.

Bangladesh, Sri Lanka, Nepal, and Maldives sought prominent projects from China even before Beijing announced the BRI. It is important to acknowledge that, despite the critiques of China's lending terms, corruption, and negotiation practices, Chinese projects in SSA countries have had some positive impacts. For example, Chinese construction of New Mooring Terminal in Bangladesh's Chittagong port, the country's largest, has helped reduce congestion. In fact, Bangladesh and India identified coastal shipping as an area for greater cooperation, and their first coastal shipping service started from the terminal in 2016.

The Chinese majority-operated terminal in Sri Lanka's Colombo port has helped boost transshipment, including to India, and Chinese-built highways have significantly expanded transit and connectivity within the country. Nonetheless, Sri Lanka's experience with China has taught the rest of the SSA nations that, despite the benefits, the terms of the loans for these projects should not be too onerous to the recipient country.

> Sri Lanka's experience with China has taught the other smaller South Asian nations that, despite the benefits, the terms of the loans for projects should not be too onerous to the recipient country.

In Bangladesh, there is recognition of the implications of reducing concessional financing and monitoring debt levels. Discussions with Bangladeshi experts revealed a sense of caution and uncertainty about BRI projects, most of which have not been finalized.[59] Yet Dhaka has already shown a willingness to pull back from work with China, whether because of dissatisfaction with the terms of a deal, pressure from India, or distaste for corrupt Chinese business practices. For instance, in 2014, Dhaka backed away from a major infrastructure project—port development in Sonadia—reportedly because of pressure from India, Japan, and the United States but also perhaps because the terms were not sufficiently beneficial. Furthermore, in January 2018, the country's finance minister announced that China Harbour Engineering Company Ltd., a major Chinese construction firm with an office in Bangladesh, had been blacklisted from doing business in the country due to attempted bribery. Nepal also appears to have learned from Sri Lanka's experience and has requested that its BRI projects be funded through Chinese grants instead of loans. Following these assertions of sovereignty by smaller states, SSA countries may now have somewhat greater leverage in negotiating with Chinese counterparts, who ultimately will need to demonstrate the success of the BRI.

2. SSA states have an insatiable appetite for connectivity projects, preferably carried out by Japan and multilateral development banks—but China is a fallback option.

Bangladesh sees itself as at the crossroads of South and Southeast Asia, while Sri Lanka and Maldives aspire to become "the next Singapore" or "the next Dubai." To capitalize on their strategic geography, SSA states are desperate for infrastructure—roads, highways, and ports—to improve connectivity both internally and externally to regional and global trading networks.

Japan traditionally has been a key source of overseas development assistance and concessional financing for SSA countries. Japan built Sri Lanka's first port terminal in Colombo and also a seawall around Maldives' low-lying capital, Malé. SSA countries have reached out to other partners such as India and the multilateral development banks.

When funding from Japan, India, or other sources is not available, countries often turn to China. This option has advantages, such as the large amount of available funding, often on concessional terms, and the speed with which credit is approved.[60] For example, in late 2012, when former Maldivian President Mohammed Waheed's government withdrew from a deal negotiated by his predecessor with an Indian company to upgrade the national airport, Japan's Taisei Corporation was publicly discussed as the company slated to develop the airport terminal component, even by *China Daily*, as late as December 2015.[61] Yet the deal for the terminal was eventually concluded by a Chinese company, in addition to the existing runway component. Likewise, after India and US investors declined to develop Hambantota, then President Rajapaksa reached out to China for an initial loan at a commercial rate, with subsequent loans at concessional rates. Now that a Chinese company has assumed responsibility for operating the port, observers will be closely tracking its success or failure.

3. SSA countries cannot only blame China for their own debt woes; the "middle-income trap" is also a factor.

Countries whose leaders pursue infrastructure through debt financing have agency in those decisions and responsibility for sustainable economic policies. Smaller countries are not necessarily victims of major powers. However, as low-income countries transition into middle-income (lower and upper) status, they face increasingly adverse circumstances from the international development finance system. In fact, upper middle-income Maldives already knows what lower middle-income Sri Lanka has recently discovered, and what newly lower middle-income Bangladesh is learning: the more a country develops, the fewer options exist for the concessional financing to which the developing country has become accustomed. Sufficient growth in per capita income triggers not only the withdrawal of concessional financing but also accelerated debt payment schedules. In the case of Sri Lanka, this problem is dire and stems from the need to repay loans to the multilateral development banks—well before taking into account loans from China that eventually will come due. Meanwhile, despite these challenges, the pursuit of infrastructure is seen as vital to national development and continues unabated.

BRI partners are all keenly aware of the risks of "debt-trap diplomacy," and three of the five SSA states—Bhutan, Maldives, and Sri Lanka—already have concerning levels of debt. Yet these countries' debt problems go far beyond the reach of China; Maldives' debt to China is only 8.6 percent of its total debt (27 percent of external debt), and Sri Lanka's debt to China is just 5.5 percent (12 percent of external debt). Bhutan has no debt to China but still has the highest debt-to-GDP ratio of SSA countries, at 108.6 percent.[62] Yet even if SSA countries avoid a debt trap, they may still fall victim to the "middle-income trap." As discussed above, after reaching middle-income levels, countries often see their economic growth slow and find it hard to move beyond this status. This challenge is particularly acute in SSA countries.

4. SSA countries still see India as the dominant power in South Asia, which limits China's potential to make strategic gains in the region.

Although observers often write about how an SSA country is challenging India's interests or "playing off" India against China, leaders are well aware of the Indian military's operational reach into their countries—whether invited or uninvited. These examples include military interventions welcomed by SSA capitals, such as delivering disaster relief in Bangladesh and Sri Lanka or averting a coup in Maldives. Conversely, Indian military and intelligence operatives intervened uninvited during Sri Lanka's war against the LTTE insurgency, as well as during the Chittagong Hill Tracts insurgency in Bangladesh. In 2017, India intervened in Bhutan's bilateral border dispute with China by deploying troops outside Indian territory. In early 2018, serious discussion took place among Indian strategists about the need to intervene militarily in Maldives. Discussions with Maldivian military representatives indicate keen understanding of India's awareness of activities taking place in Maldives and the speed with which India can deploy there.

As a result of their fundamentally asymmetric relationship with India, SSA countries do not have the political will or capability to meaningfully cross this rising power. This includes providing military basing access to China. Despite periods in these countries' histories when their leaders experienced poor diplomatic relations with New Delhi—such as during President Yameen's administration in Maldives—even then they did not offer China military bases. The leaders of the SSA countries retain enduring memories of India's operational reach and the impact of economic penalties (for example, Nepal's and Bhutan's experiences with blockades). New Delhi's prerogatives are a factor in the SSA countries' decision making that cannot be underestimated, despite China's expanding range of activities in the region.

Policy Recommendations for the United States

In general, the United States is deepening its security relationships in South Asia, with the major exception of Pakistan.[63] The United States has worked to build its relationship with India, the dominant country in the region, as a strategic partner and has bestowed on it the status of "major defense partner." As it works more closely with the SSA countries, the United States will need to take a nuanced approach toward China's expanding role in the region and should not necessarily view Chinese investments and loans as a direct threat to US influence. That said, the US strategic community will have to face the consequences of the "China fallback option" and the long-term possibility of a declining competitive advantage in the region. But many opportunities remain for US economic and security engagement with the SSA countries in ways that preserve and expand American influence, including in some cases potentially by complementing China's own initiatives.

1. Capitalize on interest in the United States and deploy US influence to help address the structural difficulties associated with the "middle-income trap" faced by developing SSA countries.

In the past few decades, the United States has essentially abandoned its leading role in advancing infrastructure development in Asia.[64] Low-income countries, such as Sri Lanka in the 1970s, benefited from financing provided by the postwar development institutions created and led by the United States and its Western allies. But as their economies grew, these countries became accustomed to such lending, and have not been able to adjust their ambitions to the new strictures of their middle-income status. The loss of concessional assistance from multilateral development banks is "the price to pay for success," in the words of an official from a small, non-SSA country. Moreover, when SSA countries do aim to pay back loans, they face challenges in generating revenue from exports due to the OECD's country-risk classification, which imposes higher insurance premiums on developing countries, thereby hurting their export credit arrangements.[65] As a result of the lending conditions imposed by the dominant international financial institutions, SSA countries struggling with the transition into middle-income status often see China as an alternate source of financing.

Still, the United States holds much appeal. It is already a top trading partner of four of the five SSA countries in terms of exports and is a sought-after provider of military assistance. These countries continue to actively seek infrastructure support from the United States, usually before reaching out to China. In other words, Washington still has plenty of space to conduct development activities in the region.

At present, one of Washington's best tools for assisting developing countries is the Millennium Challenge Corporation (MCC). Launched in 2004, the MCC is a US government foreign aid agency that provides grants to developing countries. The aim of the program is to reduce poverty and promote growth through infrastructure and good governance. In 2017, for example, Washington reselected Nepal for continuation in the MCC program and provided a $500 million grant for hydropower and road infrastructure. Yet while experts from both countries affirm the significance of the grant program for their countries, the MCC alone will not be enough to lead a US development strategy in SSA countries.[66]

To better compete with Chinese development activities in the region, the Trump administration has proposed additional steps to support infrastructure development in Asia. The National Security Strategy pledges that "the United States will modernize its development finance tools so that US companies have incentives to capitalize on opportunities in developing countries."[67] Washington followed up on this goal in October 2018 by passing the Better Utilization of Investments Leading to Development (BUILD) Act. The BUILD Act established the new United States International Development Finance Corporation (USIDFC) by combining the independent Overseas Private Investment Corporation and the Development Credit Authority of the US Agency for International Development. The USIDFC will streamline existing US development finance programs and approach the subject more strategically, with an eye toward greater competitiveness.

Bilaterally, the United States and Japan appear to be engaged in new discussions about infrastructure financing in the Indo-Pacific countries.[68] In the future, such discussions could include India, which along with Japan is working on the Asia-Africa Growth Corridor. This effort presents itself as an alternative to the BRI that offers greater transparency in the financing terms of infrastructure projects, with a focus on sustainable development. SSA countries are prime targets for connectivity under the Asia-Africa Growth Corridor.

Until these nascent initiatives yield tangible results, however, the more fundamental issue for the United States to address is how to offer viable development financing solutions for the four SSA countries currently at middle-income status. These solutions will need to focus on ensuring that these countries eventually become solvent and do not have to resort to loans from China to pay their debts or lease infrastructure to China to obtain FDI. Options include the possibility for Washington to use its influence in Western multilateral development institutions such as the World Bank to help reorient the spending habits and debt management practices of these transitioning SSA countries, while providing a longer glide path for the withdrawal of concessional assistance and accelerated payment schedules that come with middle-income status. Furthermore, Washington could use its influence in the OECD to encourage the organization to alter the policies for classifying country risk that hurt countries transitioning to middle-income status.

2. Encourage cooperative and sustainable Chinese projects; and assist India's ability to carry out projects in SSA countries.

Washington should not unnecessarily criticize China when its companies provide infrastructure opportunities in SSA countries that US companies have resisted offering. The United States indirectly benefits from the efforts of China and its state-owned enterprises on infrastructure development in the region. If these operations remain peaceful and contribute to the growth of regional trade and infrastructure, then this activity is a public good. Yet the implication of US companies' reluctance to invest in these projects means that in the long run Chinese companies will continue, for example, to expand their role in the global shipping industry, including by gaining operational control of key port terminals. However, SSA countries, as well as the United States and the international community, should draw attention to instances when China is not transparent about the terms of its lending and construction in South Asia.

In addition, when Chinese officials suggest the possibility of working with other countries on projects in SSA countries, the United States should be supportive of the idea and offer to work with China—and even India as well. For example, in April 2018, China's Foreign Minister Wang Yi suggested a trilateral corridor between China, Nepal, and India to encompass railways, highways, and ports, among other projects, and in May 2018 China's ambassador to India expressed his country's openness to working with India in Sri Lanka, Maldives, and Nepal. South Asia is among the least integrated regions in the world, so joint projects with the United States, China, India, and others will help lessen the burden of meeting infrastructure needs in the region. SSA countries would be able to build the infrastructure and connectivity they seek while diversifying their development partners. Each development partner could take on a different component of a project in an SSA country; for instance, an airport project will have multiple component tasks such as building or upgrading runways and constructing passenger and cargo terminals.

3. Monitor potentially intrusive activity by China and efforts to exclude India and the United States in SSA countries.

At present, most concerns over the potential for Chinese military basing in South Asia appear to be overstated. In the particular case of the Hambantota port, Sri Lanka provides security for the port through its own naval presence.[69] More fundamentally, Sri Lankan leaders still abide by principles agreed to with India during the latter's 1987 intervention in Colombo's war against the LTTE, in which Sri Lanka agreed not to permit foreign use of its ports in a manner that would be detrimental to India's security interests.[70] Sri Lankan officials from the Rajapaksa administration to the present day have remained consistent in their statements that they will not permit a Chinese naval base on Sri Lankan soil.

Nonetheless, the United States should be alert to areas in which China could behave aggressively, openly or even covertly, with regard to these countries. This is especially the case in the maritime domain, and particularly in Maldives, which has only limited capacity to surveil and enforce its vast exclusive economic zone. For example, SSA countries should monitor proximate Chinese research vessel deployments in the Indian Ocean. To this end, the United States should assist these countries with maritime capacity building. Finally, as Chinese economic activities are currently concentrated around the capital, observers should be alert to future efforts by China to seek access to Maldives' remote islands. The potential for such Chinese activity in Maldives and other SSA territories has clear implications for the security of sea lanes in the Indo-Pacific.

Fortunately at this stage, US-China relations in South Asia do not have to unfold in the way they have in East Asia. In contrast with the East and South China Seas, South Asia is a secondary (perhaps even tertiary) area of interest for both countries. India understandably sees China's interests in the region as threatening, given that the two countries have gone to war over their disputed border and continue to engage in occasional skirmishes. China's decades-long support of Pakistan has further soured its relations with India. Washington's threat perceptions in South Asia, however, are not the same as New Delhi's.

4. Recognize the domestic political context in which the leaders of SSA countries operate.

With the exception of Bhutan, which experienced a peaceful transfer of power following elections in 2018, all of the SSA governments are concerned about stability and regime survival. Two SSA countries, Nepal and Sri Lanka, find themselves in a postconflict transitional phase. Moreover, the future leadership in Colombo appears uncertain after the president's ousting of the prime minister, the appointment of the controversial former President Rajapaksa as prime minister, and the reappointment of the prime minister. Meanwhile, Sheikh Hasina in Bangladesh won a third consecutive term by a landslide margin in December 2018 general elections that were widely criticized. In Maldives, former President Yameen unsuccessfully attempted to cling to power after his electoral loss in September. Concerning to observers in Maldives is the rising influence of Wahhabi Islam and the rates of drug addiction and youth unemployment in this fledgling democracy. The new president, Ibrahim Solih, will need to navigate these internal circumstances while managing relations with India and China.

In the context of these concerns over instability, it is unrealistic to expect politicians in the smaller nations of South Asia not to fear the electoral consequences of disappointing public expectations. These leaders feel great pressure to show progress to their populations, and thus to deliver on infrastructure and other development initiatives within their terms in office rather than over the life of the project terms. The United States and other key stakeholders must acknowledge these political concerns and help leaders choose projects that will promote sustainable economic development and stability. A more comprehensive strategy of deploying US influence in multilateral development banks, coupled with new national development finance tools and ongoing security cooperation, will give these SSA leaders alternatives to Chinese loans while entrenching US interests in the wider Indo-Pacific region.

Notes

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