

Reevaluation the "Debt Trap Diplomacy" of China from Sri Lanka

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Abstract: This study reevaluates the "Debt Trap Diplomacy" narrative in the context of Sri Lanka's debt crisis, analyzing whether Chinese loans under the Belt and Road Initiative (BRI) are a primary cause of its fiscal distress or if domestic economic governance plays a more decisive role. By reviewing literature, financial reports, and comparative case studies, the research examines Sri Lanka's debt composition and external financing patterns. The findings contribute to the discourse on global development finance and offer policy insights for developing nations seeking sustainable debt management strategies.

Keywords: Debt sustainability; Belt and Road Initiative (BRI); Debt Trap Diplomacy; Sri Lanka.

1. Introduction

Sri Lanka's economy, traditionally dependent on agriculture, tourism, and textiles, has faced chronic instability due to external shocks and fiscal mismanagement. The 2022 sovereign default reignited debates about "Debt Trap Diplomacy"—the assertion that China deliberately ensnares BRI borrowers in unrepayable debt to seize strategic assets. The Hambantota Port lease, frequently cited as evidence, has become emblematic of this narrative [1-3]. However, a growing body of research contends that Sri Lanka's crisis was precipitated by domestic vulnerabilities: reckless commercial borrowing, tax policy failures, and weak oversight of infrastructure investments.

This study revisits the Debt Trap thesis through a systematic analysis of Sri Lanka's debt structure. By comparing Chinese loans with other liabilities (e.g., Eurobonds, multilateral debt), it assesses their relative contribution to fiscal distress [4, 5]. The paper also examines how media and geopolitical discourse have shaped perceptions of BRI financing. Findings aim to inform policymakers in developing nations navigating external debt and infrastructure partnerships.

2. Literature Review

2.1. Supporters of the Debt Trap Argument

Some people worry that loans from China cause countries to become dependent on China and lose control over important parts of their economy. A well-known example is the Hambantota Port in Sri Lanka. Sri Lanka borrowed about \$1.4 billion from China to build the port, but the port did not earn enough money to pay back the loan. Because Sri Lanka could not repay the debt, it had to lease the port to a Chinese company for 99 years. Many see this as China taking control of the port through debt.

Another concern is that many Belt and Road Initiative (BRI) contracts are not clear or open. Bhandari and Jindal (2018) studied these contracts and found that 70% have secret clauses, meaning people outside the loan agreement cannot see important details. This lack of openness makes it hard to know exactly what the countries have agreed to and whether the loans are fair.

There are also worries about China's military and political goals. The U.S. Department of Defense (2023) reported that 82% of the ports China funds overseas are located near important shipping routes. These routes are used to move goods all around the world. Having control over these ports could give China a strategic advantage and cause concern for other countries.

Discussions about the debt trap have even appeared in political cartoons (see Figure 1.), where exaggerated images and sharp humor have sparked more debate and controversy. These cartoons often portray China as a powerful lender trapping smaller countries, which has helped spread strong opinions, both for and against, the idea.



Figure 1. Cartoon "More than meets the eye"

Source: Radio Free Asia, 24 February 2025,
<https://www.rfa.org/english/cartoons/2025/02/24/cook-islanders-china/>

Hundreds of Cook Islanders protested in the capital, Avarua, and opposition leaders filed a no-confidence vote against Prime Minister Mark Brown after he signed a five-year deal with China. The pact covers trade, investment, and seabed mineral exploitation. Critics and New Zealand's government say the deal lacked transparency.

However, some experts say these worries are not always correct. They believe the situation is more complicated than just China trapping countries with debt.

2.2. Opponents: Domestic Mismanagement Was the Real Problem

Many experts say that Sri Lanka's economic crisis was

caused by several problems inside the country, not just Chinese loans. For example, Chinese debt made up only a small part of Sri Lanka's total debt. In 2022, only about 10 to 15 percent of Sri Lanka's debt was owed to China [5]. Most of the debt came from other sources.

One big problem was expensive loans from the global market. Sri Lanka borrowed \$19 billion by selling Eurobonds—these are loans from international investors. These loans had high interest rates of 6 to 8 percent, which is much higher than the lower 2 to 3 percent interest rates China offered. This made it very costly for Sri Lanka to pay back its debts.

In addition, the government made a big mistake by cutting taxes. In 2019, Sri Lanka reduced its value-added tax (VAT) from 15 percent to just 8 percent. This decision caused the government to lose about \$1.4 billion every year in tax revenue [6]. To put that in perspective, this lost tax money was almost the same as 83 percent of what Sri Lanka had to pay annually on its Chinese loans. This tax cut made it harder for Sri Lanka to manage its debt and worsened the crisis.

Sautman and Yan also point out that there is no clear proof China forces countries to give up their assets, like ports, when they cannot repay loans. This challenges the idea that China deliberately traps countries with debt to take control of their important properties.

2.3. Middle-Ground Views

Some researchers believe the truth about China's loans is more mixed. For example, Zhang and Zhang (2021) found that countries involved in Belt and Road Initiative (BRI) projects saw their economies grow faster. On average, their GDP—the total value of all goods and services—went up by about 1.2% each year because of these projects. This shows that the BRI can help countries develop.

However, there are also risks. Take Hambantota Port in Sri Lanka as an example. During its first five years, the port only made enough money to cover about 5% of its operating costs. This means the port was losing a lot of money and struggling to pay back its debts.

Other outside events also made things worse. The COVID-19 pandemic hit Sri Lanka's tourism industry very hard. Tourism income dropped by 80%, causing a big loss of money for the country and adding to its economic problems (World Bank, 2024).

Mutai and colleagues studied countries in Africa and Sri Lanka that took part in BRI projects [7]. They found no cases where a country had lost control of important assets like ports or railways because of Chinese loans. This suggests that fears about China taking over countries might be exaggerated.

2.4. Case Study: Hambantota Port in Numbers

China provided Sri Lanka with a loan of \$1.4 billion to build Hambantota Port. This loan came with a low interest rate of just 2% and a repayment period of 20 years [5]. Compared to typical international loans, these terms were quite favorable.

Despite the investment, the port did not perform as expected. By 2017, Hambantota Port was handling only about 34 ships each year. This number was far below the port's full capacity, showing that the port was not yet attracting much business. The low traffic made it difficult for the port to generate enough income to cover its costs and repay the loan.

When Sri Lanka leased the port to a Chinese company, it kept 100% ownership of the land and infrastructure. The lease

agreement also ensures Sri Lanka receives 43% of any profits made by the port [1]. This means Sri Lanka still has significant control and benefits from the port's operations.

These facts challenge the popular idea that China took full control of Hambantota Port as a result of debt. Instead, the situation is more complex, and Sri Lanka continues to have a strong stake in the port.

2.5. Other Key Data

In 2022, Sri Lanka's total debt was divided among different lenders, showing a complex picture of who the country owed money to. Almost half of the debt—about 47%—was owed to Western bondholders, mainly investors who bought Sri Lanka's government bonds on global financial markets. These loans usually came with higher interest rates, adding to the country's financial burden.

Loans from China made up only about 12% of Sri Lanka's total debt, which is much smaller than often claimed in the "debt trap" argument [5]. Additionally, 22% of the debt was owed to international financial institutions like the IMF and the World Bank. These organizations provide loans with strict conditions but often at lower interest rates.

Sri Lanka's economy also suffered major hits from unexpected events. The 2019 Easter bombings severely damaged the country's tourism industry, one of its main sources of income. Then the COVID-19 pandemic caused tourism revenues to fall even further. Together, these two crises cost Sri Lanka around \$4 billion in lost revenue from World Bank, 2024, making it even harder for the country to repay its debts.

2.6. Chinese Perspectives

Chinese researchers emphasize the positive effects of the Belt and Road Initiative (BRI) on local economies. For example, the construction and operation of Hambantota Port in Sri Lanka created around 12,000 jobs for local people, helping to boost the area's economy and reduce unemployment [2].

Studies from China also argue that fears about countries losing control of their assets are unfounded. Li examined 40 countries involved in BRI projects and found that none had to give up important assets like ports or railways because of unpaid debts [8]. This research suggests that the "debt trap" story is not supported by real evidence.

The official statement from the Mission of China to the European Union in 2022 went further, calling the idea of China using debt to trap countries a "myth." They argue that BRI is focused on cooperation and mutual benefit, not control or coercion.

The Chinese government responds by cartoons (see Figure 2.) that the Belt and Road Initiative is mainly about helping countries grow together and share prosperity. It focuses on working with other nations to build infrastructure and improve their economies. China says it does not use debt to control countries or pressure them politically. The initiative is open, respects each country's independence, and aims for mutual benefits [9].



Figure 2. Cartoon “Belt and Road Initiative”

Source: China Daily, 02 May 2017,
https://www.chinadaily.com.cn/opinion/cartoon/2017-05/02/content_29159468.htm

2.7. Conclusion

The data shows that Chinese loans were not the main reason behind Sri Lanka’s economic crisis. In fact, loans from international markets, especially expensive Eurobonds, and government decisions like large tax cuts had a much bigger impact. For example, the government’s tax cuts caused a loss of \$1.4 billion in revenue every year, making it harder to manage debt payments.

Outside events also made the situation worse. The COVID-19 pandemic caused tourism income to drop by 80%, and the 2019 Easter bombings further damaged the country’s main source of foreign money. These shocks put extra pressure on Sri Lanka’s economy.

Looking ahead, future research should focus on how different interest rates—such as lower Chinese rates versus higher Western rates—affect a country’s ability to repay debt. It should also explore ways to plan projects better, especially in cases like Hambantota Port, where the facility was not used enough to generate expected revenue. Improving planning could help countries avoid debt problems in the future.

3. Methodology

This study uses three main methods to understand Sri Lanka’s debt situation:

3.1. Case Study

A detailed case study of Sri Lanka’s debt accumulation between 2010 and 2022 was conducted, with particular focus on the Hambantota Port development project. The study reviews the terms of Chinese loans, including interest rates, repayment schedules, and contractual conditions, with the port’s operational outcomes. The case also takes political decisions that affected Sri Lanka’s fiscal health into consideration, such as the 2019 tax reforms, and situates the Hambantota Port transfer within the broader context of debt refinancing rather than asset take-over.

3.2. Data Analysis

Some quantitative analysis was conducted using financial data from the International Monetary Fund (IMF), the World Bank, and Sri Lanka’s Ministry of Finance. This includes assessment of the country’s total debt structure, breakdown of creditor shares (e.g., China, Western bondholders, multilateral institutions), and a comparative evaluation of loan terms. The study specifically contrasts interest rates, maturities, and the proportion of debt held in commercial vs concessional forms. Events like the COVID-19 pandemic and the 2019 Easter bombings are factored in to illustrate external shocks influencing debt sustainability.

3.3. Comparisons

It compares how other countries like Kenya and Pakistan managed their loans from China, to see what lessons can be learned from their experiences. The study concludes comparisons with other Belt and Road Initiative (BRI) countries, to identify patterns and divergences in debt outcomes. In Kenya, for example, the financing of Mombasa Port by China raised similar concerns, yet local ownership remained intact [7]. Pakistan’s CPEC projects, likewise, triggered domestic debate over debt burdens, but revealed different results due to its distinct political economy. These comparisons help to contextualize Sri Lanka’s experience within a broader empirical landscape and assess the consistency of the “debt trap” claim across cases.

4. Conclusion

The Debt Trap Diplomacy narrative, though widely cited in media and policy discourse, fails to account for the full complexity of Sri Lanka’s debt crisis. This study demonstrates that Chinese loans—especially those tied to the BRI—constituted a relatively modest share of Sri Lanka’s external debt and were not the main factor leading to default. Instead, the country’s crisis was the result of a combination of unsustainable commercial borrowing, fiscal mismanagement, political instability, and external shocks such as the COVID-19 pandemic and global financial tightening.

More specifically, the case of Hambantota Port illustrates how narratives can distort the realities of debt restructuring. While it is true that the project yielded low initial returns and led to a controversial transfer of operational control, it was part of a broader refinancing decision rather than an act of asset seizure. This example, along with parallel cases in Pakistan and Kenya, underscores the need to assess debt sustainability through multidimensional frameworks that consider both lender practices and borrower agency.

For developing countries, the findings offer key lessons. Governments must adopt more transparent and participatory fiscal governance systems. Public debt decisions should be subject to legislative oversight and democratic deliberation, ensuring that citizens have access to information and the right to participate in public discourse. Civil society organizations and independent audit institutions should play a stronger role in monitoring large-scale borrowing and infrastructure projects, helping prevent mismanagement and corruption. Institutional reforms that support fiscal discipline, long-term planning, and policy continuity are essential to mitigating debt risks.

For China and other major lenders, aligning financial practices with principles of sustainability, transparency, and multilateral coordination will enhance credibility and reduce suspicion of strategic motives. Greater cooperation with institutions like the IMF and World Bank can improve debt restructuring outcomes and foster shared norms in development finance.

Also, for major powers and lending institutions—including China—this study highlights the need for deeper democratization of development decision-making, both domestically and in their global engagements. Ensuring policy transparency, public accountability, and inclusive dialogue within creditor nations can strengthen the legitimacy of their international finance strategies. This shift would not only reduce the appearance of strategic manipulation but also

foster more cooperative relationships with borrower countries.

However, this study has a large quality of limitations. It relies primarily on qualitative analysis and publicly available data, which may not capture the full contractual details or informal negotiations that influence sovereign debt outcomes. The scope of comparative analysis is also limited to a few prominent BRI cases. Future research could benefit from broader countries-crossing databases, field interviews with policymakers, and formal modeling of debt sustainability scenarios under different governance structures.

To sum up, while the Debt Trap narrative may serve as a rhetorical tool in geopolitical discourse, it is of limited use in understanding the economic mechanics of debt crises. Going forward, scholarship must continue to disentangle ideology from empirical evidence, fostering a more balanced and constructive global conversation about sovereign debt and development.

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