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Beyond Conditionality: China's New Path in Foreign Aid and Sovereign Lending

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Abstract. Western-dominated development lending, led by the IMF and Paris Club, has long relied on rigid policy conditionality and structural adjustment packages that frequently deepen inequality in low-income recipient states. Since 2017, commentators and Western politicians have popularized the so-called "Chinese debt trap" narrative, claiming China deliberately saddles poorer nations with unsustainable liabilities to seize strategic infrastructure amid repayment defaults. Focusing on the most widely cited case—the Hambantota Port in Sri Lanka—this study dismantles such one-sided claims through primary project timelines and sovereign debt data. Evidence from this paper demonstrates the port initiative originated from Sri Lanka's domestic infrastructure demands rather than Chinese coercion; loan pricing remained competitive against global commercial financing at the time, and the 99-year port lease constituted a stand-alone commercial transaction to ease the nation's liquidity squeeze, not a debt-for-asset seizure. Overall, this paper argues that China's non-conditional bilateral lending represents an alternative development finance model distinct from Western orthodox approaches, while oversimplified debt-trap rhetoric conceals the complex structural drivers of developing nations' external debt pressures.

Keywords: Foreign Aid, debt trap diplomacy, infrastructure investment, sovereign debt restructuring, alternative development path

1. Introduction

Over the last two decades, long-standing lending architectures centered on the IMF and Paris Club have gradually lost their unrivaled dominance, as new state-backed aid and investment programs step onto the international stage. Of all emerging creditor nations, China's overseas development programs have generated the widest global repercussions. The Belt and Road Initiative further scaled up this infrastructure push. As Dreher et al. reported, its planned infrastructure investment was estimated to exceed US$1 trillion, encompassing oil and gas pipelines, highways and cross-border railway corridors [1].

China's rise as a major creditor triggered various intense policy responses and scholarly debate worldwide. Critics frame Chinese lending practices as 'debt trap' diplomacy. According to Brautigam, this narrative is defined as a deliberate strategy of entrapping countries through a series of unsustainable debts to gain advantages [2]. Other critics advance a "secrecy narrative" regarding China's overseas financing, which holds that China deliberately keeps loan contracts secret in order

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to take control of a preferential repayment position [3]. Building on this, this analysis will focus on the former narrative by examining the Hambantota case, which is widely cited as typical when discussing this narrative.

This paper aims to enrich the research in this area through a deeper analysis of the Hambantota case. It argues that the loan terms were reasonable under the economic conditions then prevailing, and that the port's lease was actually a response to a severe balance-of-payments crisis , rather than an attempt to seize the infrastructure. Through tracing the whole timeline of this project, this study aims to clarify the reality of Chinese foreign aid to Sri Lanka and discuss its profound influence in a broader context.

2. The Hambantota Port and 'debt trap' narrative

In 2020, the former U.S. Attorney General William Barr raised the Hambantota case to demonstrate that Beijing is "king control of the infrastructure itself" [4]. However, a closer examination reveals a more complex and instructive narrative. This paper thus reexamines this case. It begins by introducing the background, explores the operational model of China's overseas development assistance, and subsequently evaluates the debt-trap narrative.

2.1. Background of the Hambantota Port

Contrary to popular Western media framing, the entire Hambantota Port scheme emerged from Sri Lanka's own long-term maritime development planning, rather than external pressure from Chinese investors. The country's government identified the need for a deep-water southern port as early as the early 2000s and commissioned Canadian engineering firm SNC-Lavalin to complete a formal feasibility assessment in 2003, which validated the project's geographic and commercial viability. Despite receiving positive technical feedback, the Sri Lankan government's successive appeals to Western governments and multilateral bodies for construction funding were uniformly rejected. Existing research suggests Western stakeholders prioritized protecting their own regional economic interests over supporting Sri Lanka's national infrastructure agenda, leaving the island nation with few viable financing alternatives before China stepped forward [4]. According to Brautigam and Rithmire, the real concern behind this rejection was the risk of losing the project to Western countries, rather than its economic viability [4]. Therefore, Western powers such as Canada, the United States, and India prioritized their own economic interests rather than providing charitable support to a small country. In this case, China entered into this project.

2.2. China's new approach to foreign aid

According to Acker, Brautigam and Huang, China Eximbank provided US$ 307 million in commercial buyer's credit, at a fixed rate of 6.3 percent [5]. In the second phase, Sri Lanka's Port Authority took out a concessional loan of US$ 147 million at 2 percent. Notably, China provided distinct options on whether it was a fixed-interest or a floating-interest loan, reflecting the substantial space China grants to recipient countries in its overseas financing arrangement. This directly addresses the criticisms raised by the 'debt trap' narrative, which claimed that the terms offered by China were predatory. By contrast, Sri Lanka's first international sovereign bond issued that same year carried an interest rate of 8.25 percent [4], notably higher than that offered by China. Also, the former chairman of the SLPA, Saliya Wickramasuriya, stated that it was not that easy to obtain $300 million in commercial loans, especially during wartime [4]. That comparison provides

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clear evidence that terms provided by China were not outliers in the broader financing landscape available to Sri Lanka at that time. Nevertheless, the country did fall into a debt crisis; however, the data tell a different story about its origins.

2.2.1. Sri Lanka's debt crisis: not made in China

The 'debt trap' narrative claimed that it was China's loans that prevented Sri Lanka from repaying its debts and pushed it into a crisis. However, this claim is difficult to reconcile with the country's actual debt structure. According to Acker, Brautigam and Huang, international sovereign bonds accounted for 39 percent of Sri Lanka's foreign debt, while Chinese loans accounted for only approximately 10 percent [5]. More specifically, Sri Lanka accumulated US$ 15.3 billion in high-interest commercial debt and expensive Eurobonds [5]. Moramudali and Panduwawala further confirm that by the end of 2021, international sovereign bonds had reached US$13 billion, accounting for about 35 percent of total government foreign debt, with repayments on these bonds exceeding twice the share of Chinese debt [6]. This data shows that, even over the long term, Chinese debt was not the main reason for Sri Lanka's foreign debt. In this case, China's contribution was too small to be considered the core cause of the debt crisis.

Nevertheless, the real origin of this crisis lies in high-interest international capital markets. Sri Lanka's transition to middle-income status reduced its access to concessional financing from multilateral institutions, forcing it to turn to expensive Eurobonds and commercial borrowing [6]. This structural transition is the primary driver of their debt crisis. In this context, the Hambantota case should not be regarded as a scapegoat for Sri Lanka's broader borrowing strategy. Yet the port's 2017 lease deal has been invoked as a separate line of evidence, which will be discussed in the next section.

2.2.2. The lease of the port

Many Western commentators have held up the 2017 Hambantota Port leasing deal as supposed proof that China seeks to seize strategic foreign assets via lending. A careful review of the full timeline and transaction details, however, paints a vastly different picture.

The leasing agreement was not a sudden Chinese demand but the outcome of years of bilateral talks. As early as 2014, Sri Lanka's national government took the initiative to propose restructuring outstanding loans for the port and launch joint operations with two Chinese state-owned enterprises [6]. This timeline confirms Sri Lanka maintained full agency throughout every stage of the decision-making process.

Furthermore, the port handover cannot be framed as a penalty triggered by unpaid debt. Even amid a crippling balance-of-payments crunch in 2016, Sri Lanka kept making regular repayments on its Hambantota-related loans [6]. Brautigam highlights the irony that Hambantota remains the sole example repeatedly invoked to substantiate claims of debt-trap diplomacy [2].

Critically, the transaction should not be misclassified as a standard debt-to-equity swap. China Merchants Port secured an 85% shareholding by paying 974 million US dollars; all capital generated from this sale was channelled into Sri Lanka's foreign reserve accounts instead of being allocated to clear outstanding debts owed to Chinese lenders [6]. The original port loan liabilities remained formally recorded on the Sri Lankan government's balance sheet after the deal closed [6]. Overall, the episode represents a commercially viable infrastructure investment backed by Chinese financing, with the subsequent partial privatisation merely a market-based solution to address the port's weak early operational performance.

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3. China's foreign aid path

The Hambantota case can be considered a typical example of China's foreign aid approach. Drawing on this case, this section discusses three main features of China's foreign aid approach.

3.1. Infrastructure first

China's development finance model revolves around infrastructure-led growth, a core design principle that sharply differentiates it from IMF and Paris Club lending mechanisms. Traditional Western financing disburses capital only after recipient governments implement sweeping structural adjustment reforms, a precondition that often delays tangible local economic gains [7]. By contrast, Chinese lending prioritizes addressing tangible infrastructure bottlenecks, operating under the premise that upgraded transport and logistics facilities will organically stimulate trade, employment, and broader national economic expansion. Empirical quantitative research backs this logic: each completed Chinese development project correlates with a 0.41 to 1.49 percentage point lift in national GDP growth within two years of financing approval [1]. Equally foundational to this model is the principle of non-interference and non-conditionality, which preserves recipient states' domestic policy autonomy. Larsen captures this contrast as a choice between the US/EU model of 'host country de-risking' and China's approach of 'state-organised risk-sharing'—one offloads adjustment costs onto borrowers, the other keeps more project risk on the lender's side [8]. This institutional logic is further reflected in China's multilateral initiatives. The Asian Infrastructure Investment Bank (AIIB), for instance, grants equal voting rights to founding members, which contrasts with the existing system of the World Bank and IMF [9].

3.2. Non-conditionality

Another feature of China's new approach is its principle of "non-conditionality". The traditional path led by IMF and the Paris Club is characterised by Structural Adjustment Programmes, which force recipient countries to change their political systems. According to Easterly, political conditionality is the core mechanism of this model, including some specific reforms such as privatization and trade liberalization [7]. However, China removes this strict prerequisite and insists on sovereign equality.

The underlying logic of political conditionality is more complex than it appears. It implies a development discourse that has been set before. Acoording to Escobar, conditionality itself constructs the Western model as the only correct path to development [10]. This assumption places recipient countries in a position of needing to be helped. This approach may overlook local conditions and lead to mass resistance. This critique can be extended to the structural level. Evidence from Hickel et al. demonstrates that the global North continues to appropriate vast resources from the South through unequal exchange, which was estimated at US$10.8 trillion in 2015 alone [11]. This suggests that the debt is not only rooted in the domestic political structure but also embedded in deeper structural inequalities caused by unequal conditions.

In response to that concern, China offers an opposite choice. The case of Hambantota reflects its non-conditionality principle. During the whole process of this project, China never asked for a precondition for the loans [4]. That is to say, the Sri Lanka government retained full control and decision-making autonomy in this project. Take the interest rate as an example, China offered a choice regarding whether a fixed rate or floating interest rate [5]. This decision reflects the flexibility of China's policy. By choosing the type of rate, the Sri Lankan government assessed its

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market conditions, and this decision was made based on its local circumstances. As a result, the chosen rate was considered suitable and helped the country during the wartime crisis.

This principle is always framed by some western critics as 'debt trap dilpomacy'. It claims that this strategy is deliberate and aims to burden recipient countries with unsustainable debt in order to seize strategic assets [3]. Nevertheless, the Hambantota case demonstrates that the absence of conditions reflects a logic that prioritizes recipient sovereignty. Instead of forcing reform, China chooses a moderate way to aid these developing countries, and this approach has been proven successful based on current evidence.

3.3. Autonomous development capacity-building

Another feature of China's approach is its focus on the recipient countries' development capacity, instead of relying on other countries to redesign their programmes. That is to say, China's foreign aid approach emphasizes building their capacity for self-development [12]. External programme may help the economy in a short period. However, it may create a deep relience. Out of this concern, China offers a different approach.

The Hambantota case well illustrates that. Although the port itself is an infrastructure assets, the logic behind this project is capacity-oriented. After the implementation of the port project, China gradually transferred operations and management to the local government. Instead of taking control over the infrastructure assets, which is described in the narrative, China did not operate this port permanently [4]. In addition to that, the lease of the port is often misunderstood as 'asset seizure'. Actually, it is a response to a specific circumstance. Early in 2014, the Sri Lankan government had realised the need for an experienced operator. As a result, the SLPA signed an agreement with China Harbor and China Merchants Group to have them jointly develop and operate the new port for 35 years [4]. This arrangement reflects that it is driven by commercial reasons, instead of being imposed by China. More importantly, in 2017, the funds received by the local government were used to repay pre-existing creditors and bolster foreign reserves, instead of paying Chinese lenders [6]. Therefore, these two pieces of evidence show that the Sri Lankan government made its own decisions to deal with the crisis. China only provided funds in exchange for the port, and this equal commercial transaction was based on the principle of sovereign equality. Without external coercion, the Sri Lankan government retained its own agency to respond to the crisis.

The approach of capacity building has been proven successful. Evidence from Dreher et al. further supports that. Through analysing 4303 Chinese projects in 138 countries, they found that an additional project increases growth by 0.41 to 1.49 percentage points two years after its completion, which reveals that China's path causes a significant economic boost in those recipient countries [1]. In this context, it could be concluded that the logic of capacity building provides an alternative method for promoting economic development. Instead of political reform, there could be more possibilities for this approach to adapt to local conditions. Nevertheless, the model is far from perfect. Empirical analysis from Lee and Liu concerning BRI recipient countries suggests that the relationship between Chinese investment and debt sustainability is mediated by recipient institutional quality [13]. Where governance capacity is weak, even concessional lending can generate pressures, which reveals that it is far from universal. Meanwhile, some frictions may cause long-lasting problem on debt. Zambia's debt stalemate is a good example. As Wigglesworth and Sun document, China's reluctance to join the Paris Club consensus has contributed to prolonged restructuring deadlocks. When faced with the debt restructuring stalemate, China insisted that multilateral institutions share restructuring burdens. This led to direct conflict between China and

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the traditional foreign aid path, which is unfavourable for solving the debt problem in Zambia. As a result, this problem lasted for two years without a solution.

4. Conclusion

Taken as a whole, the dissection of the Hambantota Port episode presented in this paper effectively challenges the oversimplified "debt trap diplomacy" narrative prevalent in Western political and media discourse. Instead of treating Chinese overseas lending as a strategic tool to seize foreign infrastructure, the case illustrates an alternative development financing logic that centers recipient nations' independent development demands rather than externally imposed reform requirements.

Distinct from the conditionality-heavy lending frameworks operated by the IMF and Paris Club, China's bilateral cooperation model prioritizes infrastructure construction and adheres to the principle of non-conditionality, granting developing economies greater autonomy to design growth agendas that match their domestic realities. Supported by cross-country quantitative research, this infrastructure-driven approach can deliver tangible improvements to local economic vitality and also reflects the principle of sovereign equality. Moreover, China's approach also features autonomous development capacity-building. Without any external conditions being imposed, the Sri Lankan government retained decision-making authority over the whole process. This provides a completely different path for development, one that transforms traditional foreign aid into support for recipient countries to build their own capacity for self-development. Nevertheless, this model is far from perfect and points out a new direction for international development finance. This analysis carries far-reaching implications for the evolving multipolar landscape of global development finance. The international community ought to abandon rigid binary judgments that demonize Chinese lending practices and embrace a pluralistic financing ecosystem that accommodates diverse development pathways. Rather than debating the legitimacy of a single lending model, global stakeholders need to build more inclusive coordination mechanisms that integrate bilateral creditors such as China into mainstream debt relief frameworks. Only through mutually adaptive institutional cooperation can developing countries retain more choices to address their unique developmental bottlenecks, without being confined to a single Western-centric development template.

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