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Issue Brief

Sri Lanka–China Fiasco Over Shipment of Contaminated Fertiliser

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S*ummary*

China has been considered an all-weather friend of Sri Lanka. However, Chinese reaction to the Sri Lankan Ministry of Agriculture's decision to cancel an organic fertiliser deal demonstrated that China is not hesitant to take punitive action against Sri Lanka, if its interests are not fulfilled. Given the ongoing economic crisis in the country, the Sri Lankan government did not raise much hue and cry over the issue and tried to settle it by accepting the conditions of the Chinese side. Succumbing to the Chinese pressure, however, has not been received well by the Sri Lankan analysts.

China has been considered an all-weather friend of Sri Lanka. The Sri Lankans perceive China as a benign economic partner. However, recent Chinese reaction to the Sri Lankan Ministry of Agriculture’s decision to cancel an organic fertiliser deal demonstrated that China is not hesitant to take punitive action against Sri Lanka, its strategic partner, if its interests are not fulfilled. Amid severe economic crisis, when Sri Lanka is trying hard to reduce expenditure and increase foreign reserves, it had to settle US\$ 6.8 million with a Chinese fertiliser company, even after the deal was cancelled by the Sri Lankan government, due to diplomatic pressure and threat from the Chinese embassy in Sri Lanka. To add to Colombo’s distress, a complaint has also been lodged against Sri Lanka at the Food and Agriculture Organisation (FAO) of the United Nations (UN) for cancellation of the deal.

Given the ongoing economic crisis in the country, the Sri Lankan government did not raise much hue and cry over the issue. However, it has negatively impacted the perception of the Sri Lankans towards China.

Organic Fertiliser Deal

Sri Lankan government awarded the contract to supply organic fertiliser to Qingdao Seawin Biotech Group Co. Ltd., a Chinese company which was selected through global bidding, on 11 August 2021. On receiving the contract, Qingdao Seawin signed a deal with the Sri Lankan local buyers—Ceylon Fertilizer Company (CFC) and Colombo Commercial Fertilizers—to supply 99,000 metric tonnes of organic fertiliser in four shipments.

The Ministry of Agriculture, however, cancelled the deal as the sample representing 99,000 metric tonnes of organic fertiliser could not pass two rounds of the National Plant Quarantine Services (NPQS) test, as the sample was found highly contaminated with bacteria.¹

By the time Qingdao was informed about the cancellation of the deal, 20,000 metric tonnes of organic fertiliser was already dispatched as part of its first shipment on board the ‘Hippo Spirit’. The Sri Lankan authority and the CFC, therefore, obtained enjoining order against the Seawin from Colombo Commercial High Court preventing any payment to be made by the People’s Bank under a Letter of Credit (LC) opened in favour of the Chinese company upon arrival of the ‘Hippo Spirit’ at the Colombo Port.²

¹ Nirmala Kannangara, “**Govt’s Fertilizer Deal a High-Risk Adventure?**”, *Daily Mirror*, 30 September 2021.

² “**Sri Lanka Deep in Chinese Tender faux pas**”, *The Sunday Times*, 24 October 2021.

Awkward Moment for Sri Lankan Government

The government of Sri Lanka, as a national policy, restricted the imports of chemical fertilisers and agrochemicals (insecticides and herbicides) in May 2021, and emphasised organic farming in the country.³ The announcement of the ban on chemical fertiliser created panic among the farmers and they called for withdrawal of the ban as it was not practically possible to make an immediate shift from chemical to organic fertilisers. While organic farming is welcomed, the environmentalists are concerned about the fact that an immediate shift from chemical to organic fertilisers can harm the soil and production of agricultural products. Moreover, Sri Lanka's home-grown organic fertiliser is not adequate to meet the farmers' requirements. Sri Lanka did not have the capability to locally produce the required amount of organic fertiliser by the time *Maha* season⁴ began in early October. To address the farmers' concerns, the government decided to import organic fertilisers. The environmentalists were opposing the import of organic fertiliser from the beginning citing the risks of introducing alien micro-organisms to Sri Lankan soils and thereby causing irreparable environmental consequences. Import of organic fertiliser is also considered a violation of the Plant Protection Act No. 35 of 1999.⁵

In that context, the news of the import of contaminated organic fertiliser from China led to public protests by the farmers, environmentalists and the opposition parties.⁶ The issue was raised in the Parliament too. Therefore, based on the NPQS report, Sri Lankan Ministry of Agriculture suspended the US\$ 63 million tender contracted to the Chinese company. At the same time, the Agriculture Ministry made arrangements to import 1,00,000 kg of Nano Nitrogen from India after doing a required test, to meet the farmers' needs.⁷ Imported fertilisers were distributed in some areas for their immediate use as the *Maha* season began. The Agriculture Ministry also decided to obtain chemical fertilisers from the available national stocks and give it to the farmers in some districts where heavy rains washed away the organic fertiliser they had used earlier. While the government, through these measures, temporarily pacified the farmers who were apprehensive about planting seeds during the *Maha* season, it was caught up in an unpleasant situation with China by cancelling the deal.

³ **“Stringent Rules to Control Pesticide Imports Amidst Smuggling”**, *The Sunday Times*, 3 October 2021.

⁴ There are two cultivation seasons in Sri Lanka namely: 'Maha' and 'Yala', which are synonymous with two monsoons. Maha Season falls during 'North-east monsoon' from September to March, while Yala season is from May to end of August.

⁵ **“Issues Thrown up by Detection of Harmful Bacteria in Imported Organic Fertilizer”**, *NewsIn Asia*, 13 October 2021.

⁶ Kamanthi Wickremesinghe, **“The Organic Fertiliser Fiasco: Is Sri Lanka's Bio-security at Risk?”**, *The Daily Mirror*, 25 October 2021.

⁷ **“Indian Air Force Airlifts Nano Nitrogen”**, High Commission of India, Colombo, Press Release, 4 November 2021.

Objection from China

Predictably, Qingdao Seawin and the Chinese embassy in Sri Lanka reacted strongly to the Sri Lankan Ministry of Agriculture's decision to cancel the deal. Qingdao raised several objections with the Sri Lankan authorities. Firstly, the Chinese company claimed that they were informed about the cancellation of the deal after the dispatching of the first shipment. Secondly, the company alleged that the NPQS followed an unscientific method to test the sample and thereby caused severe damage to the reputation of the company.⁸ It is argued that the fertiliser concerned had passed tests of third-party agencies assigned by the Sri Lankan buyer before shipping. It held that the Sri Lankan buyers should have done the NPQS test before accepting the bid, signing the contract, and getting the import permit. According to Qingdao, the Sri Lankan buyers did not follow international trade practices.⁹ Since it was the fault of the Sri Lankan buyer and the "negligent conduct" of the NPQS, the Chinese company demanded US\$ 8 million as compensation.¹⁰ The company also demanded a joint statement from the CFC and the Sri Lankan Ministry of Agriculture saying that the shipment was turned down because of an import permit dispute, and not due to the quality of the fertiliser.¹¹ In addition, the company also indicated that the shipment should not be subjected to fresh testing of samples in future. It also threatened to lodge a complaint with the FAO if the company's name is not cleared from such "baseless allegations" against their products.

Expressing its disappointment over the entire issue, the Chinese embassy went on to blacklist Sri Lanka's People's Bank for not releasing funds for the Chinese exporter.¹²

In their defence, the Sri Lankan importers argue that there was no pressure from the Sri Lankan side to shorten the process and ship the fertiliser immediately without getting the import permit. According to the CFC, the Qingdao company was "supposed to manufacture the product after the opening of the LC on 17 September and ensure that an independent laboratory obtains a test sample and then package it before sending it to Sri Lanka after receiving the import permit to do so".¹³ Since the fertiliser was shipped on 23 September 2021, just five days after the opening of the LC in the People's Bank, the CFC suspects that the due procedure was not followed and contract terms were not respected. Qingdao, however, argues that as

⁸ **"China's Qingdao Seawin Biotech Group Co. Has its Say on Organic Fertiliser Issue"**, *Daily FT*, 9 November 2021.

⁹ Kelun Bandara, **"From Farmers' Agitation to Commercial Dispute with China"**, *Daily Mirror*, 28 October 2021.

¹⁰ Zulfik Farzan, **"Qingdao Agrees to Take Back Rejected Fertilizer & Send New Shipment – Agri Minister"**, *News1st*, 24 November 2021.

¹¹ **"Qingdao in Bid to Save Face"**, *The Sunday Times*, 14 November 2021.

¹² Zulfik Farzan, **"People's Bank Blacklisted by Chinese Embassy"**, *News1st*, 29 October 2021.

¹³ **"Was Sri Lanka Sent an Old Stock of Organic Fertiliser?"**, *The Sunday Times*, 7 November 2021.

per the international practice, it is the responsibility of the importer to obtain the import permit.

In January 2022, both parties of this dispute reached an agreement to settle the issue. As part of the agreement, Sri Lanka accepted the demands of Qingdao including the release of US\$ 6.8 million by the People's Bank.¹⁴ Qingdao Seawin agreed to arrange fresh samples of a new consignment of organic fertiliser to be tested. The settlement was reached before the visit of Chinese Foreign Minister Wang Yi to Sri Lanka on 8 January 2022. Subsequently, People's Bank was de-listed from the blacklist. The settlement of the payment, however, did not stop the Chinese company from lodging a formal complaint with the FAO against the Sri Lankan scientists and the NPQS, if not against the Sri Lankan government.¹⁵

Impact on China–Sri Lanka Relations

Both the Chinese embassy and the Sri Lankan Foreign Ministry referred to the issue as a trade dispute between the Chinese exporter and the Sri Lankan importer, and not as a political issue between Sri Lanka and China. Both sides urged the parties of the dispute to settle it through negotiation and avoid straining the bilateral relations.¹⁶ However, the statement issued by the Chinese embassy in Sri Lanka and the blacklisting of the People's Bank of Sri Lanka by the Economic and Commercial Office of the Chinese embassy suggest that the issue has not been considered lightly by the Chinese authorities.¹⁷

Blacklisting a government bank, particularly at the time of economic crisis when Sri Lanka is desperately looking for investors and solutions to address the problem of dwindling foreign reserve and revenue, is nothing but a pressure tactic of China. Sri Lankan analysts argue that the blacklisting of a public bank for a longer period would have affected Sri Lanka's transactions with the international banking community.¹⁸

¹⁴ Zulfick Farzan, **“Chinese Organic Fertilizer: Court Lifts Enjoining Order Preventing Payment”**, *News1st*, 3 January 2022.

¹⁵ **“Chinese Company Takes Fight Against Sri Lanka to UN”**, *The Daily Mirror*, 26 January 2022.

¹⁶ **“Chinese Embassy Clarifies on Organic Fertiliser of Qingdao Seawin Biotech Group”**, *Daily Ft*, 11 October 2021; **“SJB Challenges FM's Claim That Contaminated Fertiliser Only a Commercial Issue”**, *The Island*, 9 November 2021.

¹⁷ The economic and commercial office said, “the Office solemnly reminds all Chinese enterprises to strengthen risk control and avoid accepting letter of credit issued by People's Bank of Sri Lanka in international trade with Sri Lanka”. Zulfick, No.10. Wang Cong and Yin Yeping, **“GT Exclusive: Chinese Firm Sues Sri Lanka in Dispute Over \$49.7m Fertilizer Deal”**, *Global Times*, 7 December 2021.

¹⁸ B.G. Wimalarathna Banda, **“Blacklisting of People's Bank and Impact on International Business”**, *Daily FT*, 9 November 2021.

Sri Lanka and China relations remained smooth until now. China surpassed India as Sri Lanka's largest import partner in 2016.¹⁹ After coming to power, Gotabaya Rajapaksa had clearly expressed his preference towards China over India on economic matters. There has been a 61 per cent hike in Sri Lanka–China trade ever since. According to the Chinese embassy, "Sri Lanka's goods export to China grew up by 111.2 per cent year on year in the first three quarters of 2021."²⁰ In the international fora too, both countries supported each other.²¹ It is therefore strange that the Chinese embassy had taken such punitive action against the topmost Lankan public bank at this economically vulnerable moment for the country.

The recent China–Sri Lanka fiasco can be contextualised in the recent development in Sri Lanka's approach towards India and the US. As Sri Lanka's economy is going through a dire situation, the Rajapaksa administration, of late, is trying to reach out to the US and India. Earlier, on the pretext of public protest, the Rajapaksa administration had refused to sign the Millennium Corporation Challenge deal with the US, however, recently, it has signed a deal with a US-based firm New Fortress Energy, which will allow the company to acquire a 40 per cent stake of the Yugadanavi Power Plant based in Colombo and develop a new offshore liquefied natural gas terminal off the coast of the southern capital, despite public opposition. After cancelling the deal with India to develop the East Container Terminal, Sri Lanka has awarded the contract to develop the West Container Terminal of the Colombo Port to India's Adani group. China, however, would not like to see QUAD countries having any significant footprint in Sri Lanka.

It is unlikely that Sri Lanka's current approach towards the US or India would have any significant impact on Chinese influence in Sri Lanka. Yet, China does not want to allow any room for other countries to enhance their influence in Sri Lanka. In 2021, before cancelling the fertiliser shipment, Sri Lanka suspended an energy deal with a Chinese company reportedly at the insistence of India.²² When the fertiliser deal was cancelled, the Chinese authority probably tried to send out the message to the Sri Lankan authority that if Chinese interests are not taken into consideration, Sri Lanka would have to face the repercussions. Nevertheless, knowing well that other foreign countries are looking for opportunities to exert influence in Sri Lanka, China did not want to push the Sri Lankan government too much. In all the statements of the Qingdao or even the Chinese embassy, criticism was mostly against

¹⁹ In 2017 and 2018, China was the second largest importer after India, but since 2019, China continues to be the largest importer.

²⁰ **"Lanka's Exports to China Up by 111.2% So Far This Year"**, *The Island*, 13 November 2021.

²¹ China voted against the UNHRC Resolution on Sri Lanka in March 2021. Sri Lanka has supported China in its opposition against what it calls "politicizing the pandemic".

²² Meera Srinivasan, **"China Firm Slams 'Third-Party' Interference in Lanka Project"**, *The Hindu*, 22 February 2021.

the Sri Lankan importer and the scientific community and not much against the Rajapaksa administration.

It will be noteworthy to mention here that after taking a strong approach on the fertiliser issue, China has intensified its religious and economic diplomacy to reach out to the people of Sri Lanka. Within days after India and Sri Lanka signed the 'Four Pillar' economic agreement in December 2021, the Chinese ambassador visited the Tamil-dominated Northern province and tried to reach out to the local people by offering *puja* in Nallur Kandaswamy temple.²³ Chinese Foreign Minister, during his short trip to Sri Lanka in January 2022, expressed his desire to strengthen its support to Sri Lanka to deal with the economic and COVID-19 related challenges, even though nothing much was committed to Sri Lanka's request on debt restructuring.

Conclusion

The ongoing trade dispute between the Chinese exporter and the Sri Lankan importer has been probably used by the Chinese embassy to convey a message to Sri Lanka that it follows both carrot and stick policy to maintain its influence and will not shy away from using the stick if the situation so demands.

Despite the Chinese embassy's reaction to the cancellation of the fertiliser deal, the Sri Lankan government would not like to see any deterioration in China–Sri Lanka relations. Sri Lanka is heavily dependent on Chinese investment to make the Hambantota port special economic zone and the Colombo International Financial Centre run as viable projects. Sri Lanka is also heavily indebted to China. US\$ 1.5 billion currency swap facility extended by the Chinese had helped in increasing the foreign reserves in December 2021.²⁴ Sri Lanka is also expecting more assistance from China to deal with the ongoing economic crisis. On top of that, the Rajapaksas have personal affinity with China. In that context, the Rajapaksa administration would not like to spoil bilateral relations with China over a trade tussle between two companies.

Nonetheless, President Rajapaksa who was earlier hell-bent on not withdrawing the ban on the import of chemical fertiliser on the pretext of its disastrous effect on the environment might have found it not prudent to make any comment on the Ministry of Agriculture's decision to cancel the deal with the Chinese company given the resistance in the country over the issue of organic fertiliser. The Agriculture Minister, however, informed that the government was willing to consider sharing losses if the current shipment was returned and a fresh shipment with the fertiliser of accepted

²³ Meera Srinivasan, **"Chinese Ambassador's Visit to Jaffna Sparks Concern, Commentary in Sri Lanka"**, *The Hindu*, 26 December 2021.

²⁴ Uditha Jayasinghe, **"Sri Lanka Boosts FX Reserves with Lift from Chinese Swap"**, *Reuters*, 29 December 2021.

specifications was sent. He said that, if necessary, microbiologists from China and local microbiologists could sit together and test samples.²⁵

Sri Lankan government seems to have tried to settle the matter without raising a hue and cry about the Chinese approach to the issue. According to the Sri Lankan ambassador to China, the relationship between the two countries is “multi-dimensional” and is “not dependent on one single factor or even a range of minor factors”. Like any other relationship, there could be ups and downs, and misunderstandings. In his words, “the fertilizer incident has been addressed” and the relations between the two countries are back on track. He further says, “even if something like that crops up again as it possibly might, the two countries should be able to deal with them as two mature countries without getting carried away unnecessarily”.²⁶

It is unlikely that the fertiliser issue would have any serious impact on the government-to-government relations between the two countries. However, undermining the efficiency of Sri Lankan scientists and lab tests, and taking action against a public bank by China were not received well by the analysts and common people of Sri Lanka. Sri Lankan analysts are of the view that rather than succumbing to unreasonable pressures from China, the government entities must improve their capacity to negotiate or sign agreements with international companies.²⁷

²⁵ **“Chinese Fertiliser Company Makes Tough Demands to Withdraw Shipment”**, *The Sunday Times*, 14 November 2021.

²⁶ **“SL Simply Can’t Continue Asking for Financial Assistance from China-Palitha Kohona”**, The Excerpts of Palitha Kohona’s interview with The Daily Mirror, *Daily Mirror*, 7 January 2022.

²⁷ Rathindra Kuruwita, **“China Fertilizer Spat Underlines Sri Lanka’s Struggles with International Trade Deals”**, *The Diplomat*, 22 January 2022.

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