CESIF
Centre for Social Inclusion and Federalism

FOREIGN ENGAGEMENTS IN NEPAL AND NEPAL-CHINA CROSS BORDER RELATIONS

CESIF RESEARCH SERIES

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Foreign Engagements in Nepal and Nepal-China Cross Border Relations

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PREFACE

This publication is a part of the larger research series entitled 'Accessing Geopolitics, Cross Border Relations and Nepal's Development', undertaken by the Center for Social Inclusion and Federalism (CESIF). With the implementation of the new constitution and institutionalization of democracy, governments at various levels in Nepal are currently engaged in driving the agenda of prosperity. Nepal's interests in pursuing infrastructure development, connectivity and foreign direct investment have intersected with the strategic interests of great and emerging powers. Geopolitical competition at the international level between great and emerging powers as well as renewed hostilities between India and China has become an additional matter of concern for Nepal as it seeks to pursue development cooperation and projects of connectivity. Engaging in regional connectivity and development cooperation has implications for a country's strategic and security interests. Nepal needs to develop the capacity to balance its national and strategic interests while pursuing foreign policy, projects of regional connectivity, development cooperation, and foreign-direct investments. This issue of publication primarily engages in analyzing the various dynamics of foreign engagements at federal and provincial level in Nepal, the interaction between geopolitics and Nepal's quest for infrastructure development, and recent trends in Nepal-China cross border relations.

The research studies included in this series were carried out in Nepal's seven provinces during September 2021-August 2022 by a group of researchers from CESIF in collaboration with the local consultants in various districts. The CESIF researchers extensively engaged and interviewed a large number of experts at Nepal's federal capital, Kathmandu and in various provinces and districts including the federal and provincial ministers, politicians, members of parliament, bureaucrats, thematic experts and opinion leaders, border experts, security forces, local governments, businessmen, academicians, civil society, customs and immigration officers, border side communities and representatives of other government agencies engaged in dealing with foreign investors among others. Household surveys in the bordering districts with China and India and personal observation of researchers in the study districts remained a crucial part of the research to understand the changing perception and dynamics of the Nepal-China border, the trends and patterns of foreign engagements at provincial levels, perception of provinces towards foreign investments and relation between geopolitics and Nepal's agenda of prosperity. Moreover, a

number of province level consultation meetings were held to discuss the role of foreign investments in provincial development in Province 1, Madhes Province and Sudurpaschim province throughout the study period.

The first article of this series 'Dynamics of foreign engagements at the federal and provincial level in Nepal' analyzes the motives and interests of foreign actors for their engagement in Nepal along with the social, political, economic and security dynamics of foreign engagements. It further analyzes the perception of federal and provincial governments regarding these dynamics of foreign engagements. Finally, it explores the opportunities of foreign engagements, geopolitics and cross border relations in broader developmental aspects and recommends key strategies for addressing social, political, economic and security challenges of foreign engagements.

The second article of this series 'Geopolitics and Infrastructure Development in Nepal's Federal Context' focuses on the intersections of (a) geopolitics and foreign affairs, (b) cross-border connectivity and infrastructure development, and (c) FDIs and development finance. In particular, it looks at the policies, practices and attitudes (perceptions) of the federal government as well as the provincial governments. It also looks into key political economy dynamics around the above-mentioned issues.

The third article of this series 'Cross Border Relations and China's Engagement with Nepal along Nepal's Northern Border' seeks to understand how the current border security and management protocols along the northern borderland have been impacting the general livelihood of local border inhabitants with special focus on poor, women and marginalized people. It also seeks to understand China's strategic interest and engagements in Nepal's northern region regarding its perusal of public diplomacy, investments, aid and development assistance. It also explores the feasibility of future regional connectivity (roadways and railways) between the Tibet Autonomous Region (TAR) of China and Nepal with the Trans-Himalayan Multidimensional Connectivity Network.

The fourth article of this series 'Nepal China Transit Transport Agreement: An Analysis' reviews the objectives and progress of the 'Transit Transport Agreement' and identifies the factors hindering its effectiveness. It further discusses the factors behind border closure along Nepal's northern borders since January 2020 and the volume of loss caused by this soft embargo. Finally, it reviews the response from both the governments regarding the soft embargo.

We believe the findings of these studies will be instrumental to understand various dynamics of foreign engagements at the federal and provincial level, the intersection between geopolitics and infrastructure development as well as recent developments in cross border relation with China. This will aid to adopt a transparent, informed and trusted process based on which federal and provincial governments can engage with development partners, foreign actors and regional/global initiatives to promote national and public interests.

Vijay Kant Karna
Arpan Gelal

ABBREVIATIONS

ADB	Asian Development Bank
AMIS	Aid Management Information System
APF	Armed Police Force
BBIN	Bangladesh, Bhutan, India and Nepal
BIMSTEC	Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation
BOP	Border Out Post
BRI	Belt and Road Initiative
C4C	Climbing for Christ
CCO	Chief Customs Officer
CD	Capacity Development
CDO	Chief District Office
CDSC	Country Development Cooperation Strategy
CIDCA	China International Development Cooperation Agency
CNI	Confederation of Nepalese Industries
CO	Customs Office
CPC	Communist Party of China
CPN – M	Communist Party of Nepal - Maoist
CPN-UML	Communist Party of Nepal- Unified Marxist-Leninist
CSP	Comprehensive Security Pact
DAO	District Administration Office
DFI	Development Finance Institution
DFID	Department for International Development
DoI	Department of Industry
DP	Development Partners
DPR	Detailed Project Report
EPCF	Engineering, Procurement, Construction and Finance
EXIM	Export-Import
EU	European Union
FCDO	Foreign Commonwealth and Development Office
FDI	Foreign Direct Investment
FG	Federal Government
FY	Fiscal Year
FRA	Fiscal Responsibility Act
G7	Group of Seven

GDP	Gross Domestic Product
GESI	Gender Ethnicity and Social Inclusion
GHCB	Guangxi Hydroelectricity Construction Bureau
GoN	Government of Nepal
HFN	Himalayan Foundation Nepal
IBN	Integrated Business Network
I/NGO	International/ Non-Governmental Organization
ICB	International Competitive Bidding
ICT	Information and Communications Technology
IDA	International Development Association
IDCMP	International Development Cooperation Mobilization Policy
IEX	Energy Exchange Limited
IIDS	Institute for Integrated Development Studies
IO	Immigration Office
IRs	Indian Rupees
IT	Information Technology
KII	Key Informant Interviews
KTFT	Kathmandu-Terai Fast Track
kV	Kilovolt
LG	Local Government
MCC	Millennium Challenge Corporation
MCCT	Mamta Childcare Trust
MoF	Ministry of Finance
MoFA	Ministry of Foreign Affairs
MoFAGA	Ministry of Federal Affairs and General Administration
MoPS	Ministry of Public Security
MoU	Memorandum of Understanding
MW	Mega Watt
N/A	Not Available
NA	Nepal Army
NCP	Nepali Congress Party
NIA	Nijgadh International Airport
NID	National Investigation Department
NP	Nepal Police

NPC	Nepal Planning Commission
NPF	Nepal Police Force
NRS	Nepalese Rupees
ODA	Official Development Assistance
OECD-DAC	Organization for Economic Co-operation and Development's – Development Assistance Committee
OOF	Other Official Flows
PAP	People's Armed Police
PG	Provincial Government
PM	Prime Minister
PPP	Public Private Partnership
PSD	Public Security Department
SA	South Asia
SAARC	South Asian Association for Regional Cooperation
SAATIS	SAARC Agreement on Trade in Service
SDC	Swiss Agency for Development and Cooperation
SDG	Sustainable Development Goal
SDMP	Saptakoshi High Dam Multipurpose Project
SIA	Social Impact Assessment
SOP	Standard Operating Procedure
SPP	State Partnership Program
TAR	Tibetan Autonomous Region
THMCN	Trans-Himalayan Multidimensional Connectivity Network
TI	Transparency International
TTA	Transit Transport Agreement
UKHP	Upper Karnali Hydropower Project
UN	United Nations
UNHCR	United Nations High Commissioner for Refugees
USA	United States of America
USAID	United States Agency for International Development
USD	United States Dollar
VDC	Village Development Committee
WBG	World Bank Group
WTO	World Trade Organization

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Chapter 1

Dynamics of Foreign Engagements at Federal and Provincial Level in Nepal

Arpan Gelal, Yunish Ghimire, Asmita Dudhraj

A. BACKGROUND AND CONTEXT

A1. Background

This research aims to understand the working modalities of foreign actors and social, economic, political, and security dynamics of foreign engagements, geopolitics and cross-border relations at federal and provincial level. It also analyzes the perception of Federal government (FG) and Provincial governments (PGs) regarding the same. This helps to shape better policies and practices to maximize the benefits and minimize the externalities to promote Nepal's developmental goals while also promoting its national interest and national security. This study is focused on studying the interests and motivation of foreign engagements in Nepal, their working modalities, their implications, and the perception of foreign engagement at federal and provincial level. Finally, the research aims to identify how the government can benefit from foreign engagements in a broader developmental aspect.

The study is divided into four sections. The Section A of the study provides the background and context of the study. Section B presents the description of the study including objectives, research questions, study methodology and analysis method. Section C presents the findings of the study. Section D analyzes the issues and policy gaps gathered from the findings. Further, it is also important to note that this study forms a basis for forthcoming research undertakings.

A2. Context

Economic engagement of foreign actors

Assistance of foreign actors is central to pursue Nepal's objective of development and prosperity. To fulfill the gap of development financing, Nepal has been relying on diverse bilateral actors and international financing mechanisms. However, foreign actors have their own stated and hidden strategic interests in

the pursuit of their engagements, either through grants, aid, loans or foreign direct investments. It is imperative to consider the social, political, economic, security and strategic dynamics of their engagements to meaningfully engage with foreign partners while safeguarding Nepal's national interests.

Increasing geopolitical competition

Given the strategic location of Nepal in South Asia and Nepal's increasing proximity with bilateral partners to pursue her interest in infrastructural development, economic growth and cross-border connectivity; it has renewed the hostility between the great and emerging powers. With the USA's increasing interest in Indo-Pacific region, Nepal being a part of MCC grant has concerned norther neighbor China. Meanwhile, Nepal signed the BRI agreement with China which is perceived as China's growing presence in Nepal by the USA and India. This has resulted in geopolitical cross-road with significant impact in Nepal's policy environment and increased security dilemma.

Multilateral partners

International financing mechanism (for instance, World Bank Group and Asian Development Bank) has been a long-standing development partners to Nepal. While their presence in Nepal do not signify noticeable political implications, it is perceived that these agencies serve the interest of their donor countries. Nonetheless, the conditionalities of their grants and loans pose implications on the infrastructure governance. Moreover, there are own challenges and opportunities regarding the regional groupings including SAARC, BIMSTEC, BBIN among others.

Perception of Provinces towards foreign engagements

The newly formed provincial governments in Nepal aims to promote infrastructural development for which they perceive foreign sources are imperative to boost their initiatives. However, the provinces are not fully authorized to deal with foreign entities, although provinces have initiated negotiations with bilateral partners and other donors. Provinces are demanding leeway to deal with foreign actors to promote their own interests. The growing demand for para-diplomatic roles of provinces might be a significant factor to enhance the direct negotiations on transformative projects of provinces, however, its implications on national security is to be prioritized.

Challenges and implications

There is little information on the dynamics of foreign engagements (i.e., loans, grants, foreign direct investments) at the federal and provincial level. On the

national front, the geostrategic competition and its intersection with interest groups have raised questions on the pursuit of Nepal's national interest and security dimensions. Meanwhile, the social, economic, environmental, political impacts of projects of infrastructure, cross-border connectivity and geopolitics at the provincial and local level is loosely analyzed. The important concerns also lie on defining the para diplomatic roles of provinces and creating leeway for their engagement with foreign actors, along with developing capacities of the provinces for the same.

B. DESCRIPTION OF THE RESEARCH PROJECT

The overall objective of the study is to understand the dynamics of foreign engagement in Nepal. The study aims to analyze the stated and actual interests and motivations of foreign actors regarding their engagements in Nepal. Similarly, the study focuses on understanding the perception of foreign engagements at federal and provincial level. Furthermore, the study analyzes the challenges in addressing social, economic, political, and security implications of foreign engagements in Nepal. Finally, the study attempts to explore opportunities for Nepal regarding foreign engagements in a broader developmental landscape.

B1. Key research questions

The study adopted following key research questions-

a. What are the motives and interests of foreign actors for their engagement in Nepal?
b. What are the socio, political, economic and security dynamics of foreign engagements?
c. How do FG and PGs perceive socio, political, economic and security dynamics of foreign engagements?
d. What opportunities does foreign engagements, geopolitics and cross-border relation entail in a broader developmental aspect?
e. What are the key challenges in addressing a) social b) political c) economic and d) security dynamics of foreign engagements?

B2. Rationale and significance

If (a) socio, political, economic and security dynamics of foreign engagements, geopolitics and cross-border relations is tracked and analyzed at the federal and provincial level (b) perception and attitudes of federal and provincial governments are documented regarding foreign investment, cross-border connectivity and infrastructure development, and (c) if these information are analyzed on the broader national interest and communicated effectively, then it will help the government and civil society to understand the various dynamics

of foreign engagements and shaper better policies, practices and approaches to effectively deal with foreign actors and promote Nepal's national interest.

Nepal's quest for development and lack of domestic capital to finance infrastructure and connectivity projects has led to increased foreign investments in Nepal. The flow of foreign investments is appealing; however, the foreign engagements often tie up with geopolitical interests posing challenges to Nepal's national interests and endures security implications. Hidden interest and incentives of domestic actors regarding foreign financed infrastructure projects and cross-border connectivity further trumps Nepal's quest for democratic values (openness, transparency and accountability). This might further be exaggerated when newly formed provinces desire for para-diplomatic roles and demand enhanced space to deal with foreign investors and projects of cross-border connectivity on their own. A thorough analysis of foreign engagements, geopolitics and cross border connectivity is needed regarding their social, political, economic and security dynamics at federal and provincial level to create a network of informed civil society and change makers to act on this knowledge to promote national interests.

B3. Study Methodology

The research has adopted a qualitative mode of enquiry. The study used a multi-dimensional approach to gather primary and secondary information. The primary data were collected through Stakeholder consultation meetings at province levels, Key Informant Interviews (KII) and Observation. Likewise, the secondary data were collected through the review of relevant government reports, publications, datasets, news articles, periodic plans among others.

Study methods and tools were thoroughly designed to reach out women, along with marginalized and disadvantaged groups, i.e., Dalits and minority ethnic groups to gain first-hand knowledge of their experience using an intersectional approach while selecting respondents for the KII. Moreover, the study team was composed of an inter-generational representative with both senior researcher and emerging researcher.

Desk Review

In the desk review, the Constitution of Nepal 2072, National Security Policy, various acts and laws pertaining to foreign assistance and investments, foreign policy, case studies of different development projects, statements from Development Partners (DPs), scholarly articles, journals and media reports, interviews of officials published in media were thoroughly reviewed. Similarly,

engagement patterns of foreign actors were reviewed to understand how different countries have been engaging with different entities in Nepal. Desk review became essential in identifying key social, political, economic, and security challenges and opportunities for Nepal as a result of different kinds of foreign engagements.

Stakeholder meetings

Province level stakeholder meetings were organized in Biratnagar (Province 1), Janakpur (Madhes Province) and Dhangadi (Sudurpaschim province) to discuss their perception regarding foreign engagements and dynamics of foreign engagements at provincial level. The participants of the stakeholder consultation meeting included chief ministers, ministers, bureaucrats, business community, academicians, civil society, journalists, customs and immigration officials, security personnel (Nepal Army, Nepal Police and Armed Police Force), representatives of border side community among others.

KII and expert interviews

KIIs were conducted in Kathmandu, province 1, Madhes and Sudurpaschim province. Expert interviews were conducted with the politicians, bureaucrats, journalists, security personnel, civil society, businessmen, thematic experts and opinion leaders in Kathmandu and in provinces. There were a total of 31 respondents comprising chief ministers, province parliament members, CDOs, security officials, businessmen, journalists, civil society members, mayors, custom officers and immigration officers among others.

Guiding Checklist and Questionnaire

Guiding checklists and questionnaires were prepared to conduct the KIIs and consultation meetings among the relevant stakeholders. The guiding checklist and questionnaire were semi-structured, employing open- ended and close-ended questionnaires to gather the qualitative data.

B3.1. Data analysis

The data collected through various qualitative measures (desk research, stakeholder consultation meetings, key informant and expert interviews) were thoroughly reviewed and analyzed to write the report. The data analysis considered all factors such as political, bureaucratic, social, economic, familial factors to shape cross-border relations and people to people ties (at the local level) followed by state-level transactions, engagements, bilateral relations and cross border connectivity. Moreover, interactive discourse and dialogues with relevant stakeholders also formed a part of the analysis to extrapolate the report.

B4. Ethical consideration

The researchers ensured that all KII respondents were aware of the study's aim. Throughout the study, the research team was committed to the values of inclusivity, feminist principles, and human rights. The study team informed and obtained verbal consent from all respondents during the KII, assuring their anonymity unless consented, privacy, and confidentiality. While selecting respondents, the research team sought a more diverse and intersectional approach.

C. KEY FINDINGS

C1. Economic Diplomacy as a Tool for Foreign Engagement

As the world becomes more interconnected, economic diplomacy as a tool for foreign engagement has become more prominent. Economic diplomacy is used by a country to advance its foreign policy objectives and the country's political, economic and strategic goals. These tools come in different forms such as foreign aids/grants, foreign investments, and trade among others.

Nepal is precariously located between India and China, two rising powers competing to expand their global influence. South Asia as a regional system has become a center of gravity with India and China's rise on the global stage, further emboldened by the latter's emergence as a counter hegemon to the United States. This makes Nepal's geographical location between India and China geopolitically and strategically important which has become a basis for increasing foreign interests and engagements in Nepal. Furthermore, the increasing foreign aid and investments in Nepal from various foreign actors is an indication that economic diplomacy is increasingly used to further their political and strategic goals.

Different multilateral partners have been engaging in Nepal to support its development initiatives. Nepal has been a strategic juncture for different international actors to pursue their specific interests. Some of the major bilateral partners to Nepal have been China, India, USA, and Japan among others. Likewise, the major multilateral partners that have their presence in Nepal are IDA (The World Bank Group), and Asian Development Bank (ADB). However, Nepal's capacity and diplomatic efforts to constructively benefit from these foreign engagements and prioritize its national interest in the cross-road of increasing geopolitical interests in Nepal is questionable.

For the purpose of this research, we will be mainly focusing on economic engagements of foreign actors (multilateral and bilateral) including development

assistance, aids/grants, and FDIs and their implications at federal and provincial level along with associated challenges and opportunities.

C2. Key Interests and Motivation of Foreign Actors in Nepal

C2.1. Bilateral Partners

Some of the major bilateral partners to Nepal are the USA, China, India, Japan, and the UK. Nepal established the first bilateral ties with the UK in 1816 and consequently with the US, India, France, and China, all between 1947 and 1955[1] . Initially, most of the bilateral partnerships were established to cooperate in the issues of development and trade[2]. Currently, geopolitical factors increasingly dictate bilateral relationships.

The USA

The USA has remained one of the prime development partners since Nepal opened up to the outer world in 1950. Initially the main motive for the US engagement in Nepal was to prevent communism entering the country (Khadka, 1993). Thus, it offered economic support and sent volunteers through the Peace Corps to aid development projects and to keep a close eye on the communist activities along the borders of Nepal.

Currently, the USA has been engaging in Nepal mainly through USAID and highlights that its main motivation for engagement in Nepal is to promote inclusive and effective governance, sustainable economic growth, health and nutrition, primary education, and build resilience to climate change and natural disasters. Some of the major sectors of investments in Nepal from 2016 to 2021 have been: Health and Population, Governance, Agriculture, Education, Humanitarian relief, Infrastructure, and Economic Growth. Similarly, USAID has also put forth Nepal 2020-2025 CDCS (Country Development Cooperation Strategy) to facilitate Nepal achieve the goal of reaching middle income status by 2030. The three key strategic interests of the USA as highlighted by the Assistant Secretary for South and Central Asian Affairs, Donald Lu are: economic development, improve trade and investment, and respect Nepal's independence and sovereignty[3].

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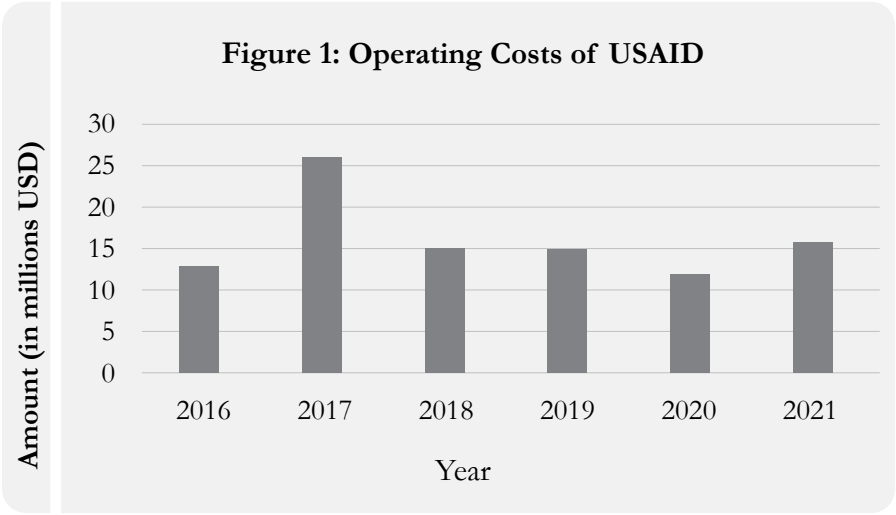
1 Information from Ministry of Foreign Affairs, Retrieved from: https://mofa.gov.np/foreign-policy/bilateral-relation/

2 Information from Ministry of Foreign Affairs, Retrieved from: https://mofa.gov.np/nepal-us-relations/

3 Bhattarai. K. D. (2021). US engagements to grow in Nepal, with or without MCC. The Annapurna Express, https://bit.ly/3OwGcRN

USA openly admits that its development assistance is not a charity. It classifies it as a strategic development assistance aimed at promoting the stability in some of the most vulnerable parts of the world which would ultimately protect America's security interests[4]. Furthermore, it is clear that through economic instruments such as Millennium Challenge Corporation (MCC), the USA aims to counter the Chinese influence in Nepal. It has an overarching geopolitical interest for engagement in Nepal apart from its political and strategic interests.

USAID also channels its funds to generate employment opportunities for its citizens (Rahman & Giessen, 2017). While analyzing the USAID data from 2016 to 2021, a significant portion has been spent on operating costs which include salaries and benefits for the staff. The year-by-year breakdown of the operating cost of USAID in Nepal from 2016-2021 can be found in Figure 1 below. Although the US contributes a significant amount every year for the development initiatives in Nepal, a large portion of it is spent servicing their own citizens. This raises a question on the stated and actual motivation of its engagement in Nepal. However, the USA has remained one of the biggest ODA partners to Nepal (see Annex 1).



Source: USAID Data Portal

4 Politico. (2017). Why foreign aid is critical to U.S. national security, https://politi.co/39XJD5h

The rise of China as a global power has heightened American interests in the Asia. Furthermore, the USA has put forth an Indo-Pacific Strategy to counter increasing Chinese influence in the region. Nepal being in a strategic juncture in the South Asian region attracts the interest of both rivals. The controversies surrounding the MCC compact is a recent manifestation of this strategic interest of competing powers. The MCC, which is regarded as a counter to BRI, came into controversy after the former Secretary of State, Mike Pompeo stated MCC to be a part of the Indo-Pacific Strategy. Despite the eventual ratification of the compact, it is largely debatable whether MCC is a part of the Indo-Pacific Strategy. While the compact was heavily politicized domestically, Donald Lu, a United States official stated that the failure to ratify the MCC compact could compel the United States to rethink bilateral ties and priorities despite claiming that Nepal was free to make decisions regarding MCC ratification on its own. Many analysts perceived this statement undiplomatic. It can be observed that the United States strategy towards the parliamentary ratification of MCC in Nepal moved away from persuasive to coercive.

China

China highlights that the Chinese engagements in Nepal including BRI is important to improve infrastructure, trade, finance and people-to-people connectivity to facilitate the growth by enhancing the capacity for independent development[5]. China has increasingly expanded its engagements in Nepal in the areas of hydropower and infrastructure development for connectivity.

After the abolition of monarchy in 2008, China's engagements have significantly diversified in Nepal. Historically, China was limited to the infrastructure development sectors. Currently, it has started working in the soft sectors along developing direct relations with political parties of Nepal showcasing a visible presence in Nepal's political front[6]. It has also significantly ramped up its foreign aid which is regarded as a counter to the presence of the USA and India in Nepal.

A study conducted by Carnegie on four South Asian countries including Nepal found that China leverages specific vulnerabilities present at these countries for its interests[7]. The vulnerabilities exploited by China are fragile state institutions,

5 White paper published by the State Council Information Office of People's Republic of China, Retrieved from: http://english.scio.gov.cn/node_8021417.html

6 Bhattarai. K. D. (2020). China's growing political clout in Nepal. The Diplomat. https://bit.ly/3Nocn4N

7 Pal. D. (2021). China's influence in South Asia: Vulnerabilities and Resilience in four countries. Carnegie. https://bit.ly/3y0xXXe

weak civil society, and capturable states and systems. It is highlighted that China uses economic engagements in the region to exert influence. Similarly, AidData conducted a comprehensive study on the effects of Chinese development projects on the public opinion. The study found that the public approval is high in the areas of completed Chinese development projects . It can be argued that the Chinese approach of flowing aid and investments in a specific country like Nepal has helped build goodwill and trust among the people which further enhances its soft power in the country. That is particularly true for Nepal too given the public sentiments have been pro Chinese, especially after 2015.

Chinese investments and aid in Nepal have increased significantly over the years. ODA from China saw a significant increase from 58 million in 17/18 to USD 150 million in 18/19. Nepal signed the BRI agreement in 2017. As per the AidData report, Chinese commitments increased on an average of 63% after a country joined BRI. Signing of the BRI agreement paved the pathway for the massively increased ODA inflows in the country.

Apart from economic engagements, China has also increased its political engagements in the country. China actively expressed their discontent towards the American coercive tactics in the ratification of MCC in Nepal, indicating their increased political interest in Nepal. Similarly, most analysts argue that China played a significant role in mediating the unity of communist parties of Nepal in 2018. Later in 2021, China actively mediated to resolve the differences within the Nepal Communist Party (NCP) to prevent the split. This was demonstrated by the increased 'behind-the scenes' meeting between the leaders of the ruling party and Chinese ambassador to Nepal, Hou Yanqi[9].

One of the objectives of Chinese engagements in Nepal is to surveil over the activities of Tibetan refugee communities in Nepal and adhere Nepal to One China policy. It has previously used aid and investments as leverage to stop issuing the movement passes to Tibetan refugees from Nepal to India.

India

India has been a traditional partner to Nepal with a long-standing history of cooperation between the two countries. It has had a strong foothold in the political, social, and economic spheres of Nepal. The treaty of 1950 between Nepal and India entailed that both the government of Nepal and India to

8 Aiddata. (2022). Can aid buy public support? Evidence from Chinese development finance. https://bit.ly/3ucViEa

9 Shahi. D. (2020). Is China micro-managing Nepal politics? Nepali Times. https://bit.ly/3bGgADO

prioritize foreign assistance in each other's countries, which paved the path for Indian aid disbursement in Nepal.

Initially, Indian aid and investments were targeted to counter the US engagements in Nepal. Gradually, the focus shifted towards countering Chinese presence. As the Chinese engagements have increased in Nepal, India has also ramped up its engagement to keep Nepal within its sphere. For instance, under the 'Aid to Nepal' budget in 2019-20, India has provided INRS 1,200 crores to assist Nepal in its economic development[10]. India is also one of the highest ODA partners to Nepal[11]. Although India has been one of the biggest development partners to Nepal, there is a widespread perception among the people in Kathmandu that India attaches benefits and conditionality to the aid schemes and uses them to promote its political interests (Adhikari, 2014).

Along with foreign aid and grants, India has also been a major trade partner to Nepal. The trade data between Nepal and India suggests that the trade volume has increased significantly between the two countries. The total import has increased from USD 159 million in 1995 to USD 5.85 billion in 2020. Similarly, the total export has increased from USD 45.3 million in 1995 to USD 611 million in 2020[12]. However, the growing trade deficit has been a major economic concern to Nepal. The analysis of trade treaties between the two countries indicate that they have largely favored India[13]. Furthermore, policies put forth by India such as banning the import of refined soybean and palm at times, to protect its domestic industries have negatively impacted the businesses in Nepal. This asymmetry in trade policies has pushed Nepal to look for better market options.

Another major economic engagement of India is seen in the sector of shared water resources. India has used economic investments in Nepal for the construction of hydropower plants and dams for its benefits. For instance, SDMP (Saptakoshi High Dam Multipurpose Project) and UKHP (Upper Karnali Hydropower Project) projects were constructed through Indian investments, and in the MOU of these projects, it is highlighted that any withdrawal by upstream states requires prior approval from the developer (India), giving control of these projects to India (Tandan, 2021). It is imperative that India has used economic tools to garner control over the water resources of Nepal.

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10 Jha. H. B. (2020). India's continuing role in Nepal's economic development. ORF. https://bit.ly/3HX-8jax

11 The ODA flow from India to Nepal can be found in Annex 1

12 https://oec.world/en/profile/bilateral-country/npl/partner/ind

13 Findings from the previous research conducted by CESIF.

India has historically used economic engagements in the form trade embargoes to push its political and strategic agendas in Nepal. The first trade embargo was imposed in 1969/70 to counter Nepal's demand for separate treaties for trade and transit after the expiration of the trade and transit treaty of 1970. Similarly, the second embargo of 1988/89 which lasted for 15 months was fueled by India's discontent on Nepal's decision to declare itself as a 'Zone of Peace', demand of separate treaties for trade and transit, and purchase arms from China. Likewise, the unofficial border blockade of 2015 is widely viewed as a coercive tool to influence internal domestic affairs of Nepal[14]. Trade embargo is seen as a tool used by India as a response to Nepal's political decision-making (Chand, 2018).

Nepal-India ties have seen major setbacks in the last few years, since the economic blockade of 2015 to the recent border disputes. This has further hampered the historical Nepal-India relationship. These political setbacks have also enchanced anti-Indian sentiments among the public of Nepal. China has used this opportunity to increase its presence in Nepal. Thus, to reset the declining ties, India has been using economic engagement through increased aid and development cooperation.

Vested interest of bilateral partners

Most of the key informants argued that although bi-lateral partners use economic tools (mostly grants and aids) to aid Nepal's development, they have vested political and strategic interests regarding their engagements. This is mainly true for the US, India, and China. Other bi-lateral partners such as Switzerland, Norway, and Japan have limited political motivation. However, they have stronger economic interests in Nepal. A key informant who has been closely working with a donor agency of one of these countries mentioned -*"They use investments to advance the economic situation of Nepal and use it to benefit the private sectors of their respective country."* Along with political and strategic interests, China also has economic interests in Nepal which is evident in contracting and procurement of hardware and software in Chinese funded or invested projects in Nepal. They mostly use Chinese contractors for development projects which ultimately benefits their private sector. Since there is no knowledge and skill transfer through this procedure, Nepal does not gain long term benefit. Similarly, China also charges higher interest rates on the loans issued to receiving countries. Although China has been liberal to Nepal in charging interest rates compared to other countries, the rates are much higher as compared to other bi-lateral and multilateral partners[15].

14 Findings from previous research conducted by CESIF.
15 Findings from previous research conducted by CESIF.

C2.2. Multilateral Partners

Two of the major multilateral partners of Nepal are International Development Assocation (IDA) of the World Bank Group and ADB. ADB has mentioned that it works in line with the priorities set by Nepal government and supports Nepal in its growth and development by promoting *inclusive growth, developing human capital, and transforming agriculture*[16]. Hence, ADB has engagements in both hardware (infrastructure development) and software (skills development) sectors. Likewise, the WB has specified that it primarily works in strengthening public institutions, private sectors, inclusion and diversity[17].

In the case of multilateral partners, their engagement in Nepal does not have a visible political interest. According to research conducted by Clark & Dolan (2020), the USA being the largest financier of the WB, the staffs under the WB design policies that promote the American interests. Furthermore, the research highlights that *"countries with strong political ties to the United States receive fewer WB conditions."* Similarly, a survey of development policymakers and practitioners in 2014 and 2017 conducted by AidData found that multilateral institutions especially World Bank has substantially greater influence on government's policy making process[18]. Different research has indicated that the World Bank uses instruments such as Development Policy Loans and the provision of analytical and advisory services to influence policy making of a country (Masaki & Parks, 2019; Bogetic & Smets, 2017). The government of Nepal and IDA (The World Bank) signed a deal of USD 266 million in 2019 which is available under Development Policy Credit and will be utilized through national budgetary system[19].

Similarly, a few key informants highlighted that the major multilateral partners of Nepal such as IDA of The World Bank Group and ADB are primarily driven by profit making motives. One of the key informants mentioned that *"ADB and the WB mostly give out loans with small grant components, it is true for Nepal as well. So, if we analyze from a long-term perspective, their main goal is to achieve banking interests."* For instance, the portfolio of ADB in Nepal consists of 35 loans and 6 grants[20].

C3. Working modalities of foreign actors

Most of the Development Partners (DP) either use top-down approach or bottom-up approach whilst engaging with different tiers of government. Top-

16 Information from ADB's website. Retrieved from: https://bit.ly/3OJIoVQ

17 Information from the World Bank's website. Retrieved from: https://bit.ly/3HZqe02

18 Aiddata. (2018). Is development cooperation tuned-in or tone-deaf? https://bit.ly/3y1yRTs

19 Information from the Ministry of Finance. Retrieved from: https://bit.ly/3ub29hk

20 Data from the official website of ADB. Retrieved from: https://bit.ly/3M8kBNx

Down approach means that a DP usually approaches the Ministry of Finance (MoF) with a certain project to be implemented either at provincial or local level. After getting prior approval from MoF, DPs can initiate their project by periodically updating about the project to the ministry.

Through the bottom-up approach, a DP can directly consult with the Provincial Governments (PGs) for need identification and designing of the projects as per their needs. After designing a certain project in association with PGs, a letter is sent to the MoF for final approval. Although top-down and bottom-up are two different approaches, MoF or Federal Government (FG) is at the center.

While analyzing the working modalities of different DPs, some prefer top-down approach while others prefer bottom-up approach. Some of the DPs such as Swiss and Norwegian view Nepal's federalism as a progressive step, and want to contribute in the capacity building of PGs and Local Governments (LGs). Hence, they mostly prefer the bottom-up approach. Similarly, while implementing bigger infrastructure projects, DPs usually prefer top-down approach because PGs lack technical expertise for designing the projects[21].

Aid modalities of DPs

An important aspect of exploring working modalities is understanding the aid modalities. For instance, if a DP chooses to disburse the aid through on-budget on-treasury system for a certain project, then the government is solely responsible for the entirety of the project from procurement to contracting. As highlighted by the Development Cooperation Policy of 2019, Nepal government prefers on-budget on-treasury modality. However, DPs have concerns on the government's ability to effectively utilize the aid. They prefer to disburse the aid through an on-budget off-treasury mechanism which allows the DP to adopt its own implementing bodies. Both on budget on treasury and on-budget off-treasury aids are reflected in the government's Red Book.

C4. Dimensions of foreign engagements in Nepal

C4.1. Economic Dimensions

Aid Dependence

Nepal has high dependence on foreign loans and grants. For the financing of 21/22 budget, Nepal has anticipated to finance 23% of the consolidated budget through foreign grants and loans[22]. This heavy dependence on foreign sources poses a significant risk if the projected loans and grants do not get materialized.

21 Information from interviews with experts working in the sector.

22 Data from the official website of UNICEF. Retrieved from: https://uni.cf/3R06VrU

The risk has become even more significant given the financial instability around the world caused by the pandemic and changes in geopolitical situation. One of the major sources of foreign currency reserves in Nepal is remittance, which was severely affected by the recent pandemic. Furthermore, the Ukraine crisis resulted in a hike on petroleum prices which further adds to the depleting foreign currency reserves in Nepal.

According to a key informant- *"The loans taken from Exim Bank of India is one of the few bad loans for Nepal."* While agreeing for the loan, there were clauses that allowed only Indian contractors and Indian construction materials were given high priority. Similarly, Chinese investors also heavily prioritize using their own contractors and specialists for the projects funded by them. These kinds of deals do not allow the transfer of knowledge and skills, which negatively impacts the long-term development prospects. Furthermore, it makes Nepal dependent on others for skilled manpower and technology.

Aid Effectiveness

Under the Ministry of Foreign Affairs (MoFA), Policy Planning, Development Diplomacy, and Overseas Nepalese Affairs Division is responsible for conducting economic diplomacy which includes promoting foreign trade and investments, development cooperation, technology transfer, tourism, foreign employment, and climate change[23]. MOFA has been criticized for its inefficiency to engage in economic diplomacy. The main reasons being insufficient budget allocations to promote economic diplomacy, lack of plans and policies to promote foreign investments and aids, and lack of lobbying mechanisms in the host countries (Shrestha, 2021).

According to research conducted on the effectiveness of foreign aids in Nepal, Swiss aid has been very efficient. The disbursement rate has been around 94% of the total aid committed by the Swiss Government. One of the main reasons for the effectiveness of Swiss aid is because most of it is disbursed directly into local communities through Swiss Agency for Development and Cooperation (SDC), NGOs, and INGOs[24]. However, various studies have indicated that there is no direct correlation between foreign aid and economic growth of a recipient country. Furthermore, given the weak institutional capacity and rampant corruption, the efficient and productive use of foreign aid has always remained questionable.

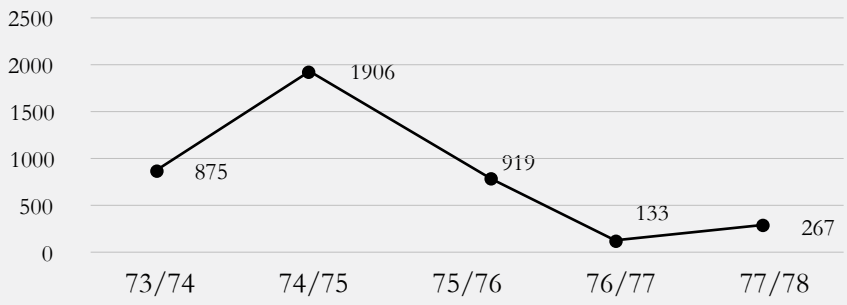
23 Information from the website of the Ministry of Foreign Affairs. Retrieved from: https://bit.ly/3uc5HQh

24 Mishra. A. K. & Aithal. P. S. (2021). Foreign aid movements in Nepal. https://bit.ly/3I1EVQr

Employment Generation

There is a positive correlation between the total foreign investment and employment generation. FDIs in the service sector have generated the most employment opportunities, whereas the construction sector has generated the least amount of employment opportunities (Kharel, 2020). The amount of FDI in study provinces (Province 1, Madhes Province, Sudurpaschim Province) has decreased since FY 74/76 which has also resulted in a decrease of the numbers of employment generated

Figure 2: Total Employment Generated by FDI in Study Provinces



Source: Ministry of Industry, Commerce and Suppliers

Cost and time over-run

Cost and time overrun due to different factors has been a major concern in development projects in Nepal. Chinese contracted projects have mainly faced these issues. The massive cost over-run in the Pokhara International Airport is the recent example. Due to the delay and financial irregularities in the implementation of projects, they end up costing more than the initially estimated cost. The malpractices among the Chinese contractors and Nepali officials have led to time overrun, cost escalation and loan extensions on most of the projects under Chinese contractors. Most of the Chinese state investment projects compromise loans and meager grants elements. With forced time and cost overrun, Chinese enterprises tend to escalate the loan volume through various claim plans through the loop holes in the tender agreements by exaggerating the cost and pricing of the project.

Debt Vulnerability

ADB conducted a research in 2019 on debt vulnerability of Nepal which highlighted that the external debt distress of Nepal is 'low'. One of the main reasons for such classification is that most of the major loans taken by Nepal are concessional loans. As indicated by the debt data, two main creditors to Nepal are IDA (The World Bank) and ADB (See Table 1). The interest rates charged by the World Bank is around 1%[25]. Even though the risk of debt distress is low for Nepal, external debt has been gradually increasing every year.

Table 1 External Debt Composition (As of FY 19/20)

Creditors	No. of Debt Instruments	Outstanding Debt (in Rs million)	Debt (%)
International Development Association	130	386,104.28	47.9
ADB	118	272,109.74	33.83
Japan International Cooperation Agency	9	36,616.63	4.54
IMF	1	26,389.01	3.27
Export Import Bank of China	4	26,105.17	3.24
EXIM Bank, India	4	24,908.39	3.09
European Investment Bank	1	4,072.05	0.51

Source: Public Debt Management Office

Furthermore, through BRI agreement, Nepal has identified nine projects. No projects under the BRI agreement have moved forward due to the disagreement on the financing modalities of the projects. Nepal is arguing for concessional loans and grants from the Chinese counterpart, whereas China is adamant on giving out loans at high interest rates.

Debt vulnerability with China has been a major concern after signing BRI. According to a report by AidData, which studied over 13,000 Chinese funded projects from 2000-2017, China funds projects mainly through ODA (official Development Assistance) and OOF (Other Official Flows). ODA are concessional in nature and includes grants, technical assistance, and concessional loans, while OOF includes non-concessional loans and export credits[26]. The

25 Information from Nepal Development Report by the World Bank. Retrieved from: https://bit.ly/3Ooh5kd

26 Aiddata. (2021). Banking on the Belt and Road: Insights from a new global dataset of 13,427 Chinese development projects. https://bit.ly/3QWuGAL

OOF adds a heavier burden on the recipient country. China's funds have been more liberal towards Nepal as around half of the development finance received between 2000-2017 have been in the form of ODA[27]. The ODA to OOF ratio for the same period in Asia was 1:5.2 which means that for every dollar of ODA issued was matched by 5.2 dollars of OOF in the region. According to the data from Development Cooperation Reports, the ODA from China saw a significant increase from USD 58 million in 17/18 to USD 157 million in 18/19. Nepal signed the BRI agreement in 2017. It is to be highlighted that after a country officially joined the BRI, official financial commitments from China saw an increase of 63% on average. Thus, signing the BRI could be one of the reasons for the significant increase of 61.47% in ODA for FY 18/19 as compared to other years.

C4.2. Political Dimensions

Influence in the domestic politics

Influencing domestic politics is a tool used by different foreign actors to forward their vested interests in the country. Historically, India has had a strong foothold over the internal politics of Nepal. It has used economic blockades as a tool to influence policy. The blockade of 1989 was a result of Nepal's growing ties with China and the decision to purchase weapons from China. Similarly, it is also argued that the blockade of 2015 was a way to influence Nepal's new constitution drafting process.

Although China has historically distanced itself from Nepal's internal politics, it has also increased its influence in the politiccal landscape of Nepal over the last few years. It is evident that China had close connections with the Nepal Communist Party (NCP). In 2019, NCP signed a MoU with the Communist Party of China (CPC) to officially establish a sisterly relationship[28]. Similarly, China also played a major role in unifying CPN-UML and CPN Maoist Center to form NCP and also made attempts to reconcile the two sides before the formal split. Furthermore, China also made comments regarding the MCC ratification process which is an indication of its active interference over the domestic politics of Nepal.

Likewise, the USA has used coercive tactics to push the ratification process of MCC through the parliament. Nepal has faced pressure from the USA and other human rights organizations to provide identity cards to the Tibetan

27 Zeeshan. M. (2021). How China uses development finance strategically in South Asia. The Diplomat. https://bit.ly/3u7tvoE

28 myRepublica. (2019).NCP, CPC sign MoU pledging to deepen cooperation. https://bit.ly/2lenNRm

refugees present in Nepal. On the other hand, China has been pressuring Nepal to keep a close eye on Tibetan activities. Although Nepal's foreign policy clearly mentions that it would not allow any activities within its territory which would undermine the security of its neighbors, it does not have a clear policy regarding Tibetan refugees[29].

Corruption

The cost and time overrun for development projects can mainly be attested to corruption regarding foreign investment projects. The government has detailed guidelines on contracting development projects. In most scenarios, the government has to offer contracts through a process of International Competitive Bidding (ICB). However, many development projects are awarded without following the ICB procedures. One of such projects is West Seti Hydropower projects which was contracted to a Chinese company, Three Gorges International Cooperation[30]. Similarly, Budi Gandaki hydropower project has also suffered due to the lack of consistent policies and issues surrounding the contracting of the project. According to a report prepared in 2015, the project was estimated to cost around Rs 270 billion. Currently, it is estimated that the project will cost more than Rs 1 trillion taking inflation into factor[31].

Recently, the government signed a deal with a subsidiary of a Bangladeshi company Tiger IT Bangladesh for embossed number plates. The company was blacklisted by the World Bank for fraud, which raises the question of foul play from the government[32]. Hence, corruption in awarding of development projects has resulted in delayed project implementation which further increases the cost of projects.

The audit conducted by DFID (now FCDO) on the UN's disaster risk management program in 2014 outlined that there were cases of misreporting and recording of payments which is indicative of weak financial mechanisms in Nepal[33]. Similarly, another research highlights that there is a need for 'more analytical information than what is currently available to them'. The transparency

29 Poudel. S. S. (2022). Nepal is caught between the US and China on Tibetan refugee issues. The Diplomat. https://bit.ly/3HY5BS2

30 Business Standard. (2017). Chinese infrastructure projects in Nepal running way behind schedule. https://bit.ly/3Ata9OP

31 Lamsal. H. (2022). Chinese company's license to build budi gandaki project scrapped , Nepal says it'll build the 1200 MW project on its own. myRepublica. https://bit.ly/3OthXnv

32 Kumar. R. (2022). Embossed plate company involved in scam. Nepali Times. https://bit.ly/3Ai3fvH

33 Cox. S. (2015). Where is Nepal aid money going. BBC News. https://bbc.in/3I3Yw2y

regarding the aid data is important in ensuring the effective utilization of aid. Most of the cases of corruption are seen in the aid disbursed through the on budget on treasury modality. Once a Development Partner (DP) chooses to use this modality, the government is solely responsible to mobilize and channel the aid as per its own conditionality for the implementation of the project. A key informant working with a DP highlighted that DPs prefer to disburse a certain percentage foreign aid through on-budget off-treasury mechanisms so that they can lead the implementation and monitoring of projects. This can mainly be attributed to corruption and misuse of the funds from the government's part. Furthermore, various international aid agencies have argued that lack of transparency on the government side and being asked to pay fees to the government has hampered their work[34]. The government introduced AMIS (Aid Management Information System) in 2019 to keep records of ODAs (Official Development Assistance) and their utilization which is a positive direction towards maintaining transparency.

Geopolitical Implications

Nepal's strategic location between two emerging economies, India and China, has huge implications in geopolitical instances. Geopolitics has been mainly shaped by economic dominance. Nepal acts as a buffer zone between India and China. Hence, it has the pressure to promote balanced policies, especially for development cooperation. On the other hand, Nepal can also benefit from the geopolitical competition between the US, India and China in the region, mainly through economic instruments such as MCC and BRI.

Succumbing to the interest of a foreign actor can undermine the relations with another. For instance, the historical ties between India and Nepal have declined due to the increased Chinese presence in the country. Likewise, the rise of anti-Indian sentiments in the general public has also hampered the people-to-people relationship between the two countries. Similarly, the relationship between the USA and Nepal was at a low point before the ratification of MCC, as an American official made a statement that *"US will review its ties with Nepal, if MCC was not ratified*."[35] The issues surrounding Tibetan refugees have put Nepal into a difficult situation. While the US has been pressuring Nepal to provide refugee cards to Tibetan refugees, the move would be in violation of Nepal's One China policy, making the matter geopolitically sensitive for Nepal.

34 Pattison. P. (2015). Aid agencies accuse Nepal government of hampering their work. The Guardian. https://bit.ly/3bBJgNT

35 Giri. A. (2022). Top American official says US will review Nepal ties if MCC compact is not ratified. The Kathmandu Post. https://bit.ly/3OtiqWN

Despite vested interests, they are important development partners to Nepal. Thus, Nepal cannot afford to deteriorate ties with them.

C4.3. Social Dimensions

Local experiences with the hydropower development project in Rasuwa district entails that the social dynamics have changed due to the migration of Chinese laborers, engineers, and project officials in Timure. It resulted in an increasing prevalence of alcoholism, black marketing, prostitution, and environmental degradation. Similarly, the police personnel in the area have also indicated that the violence induced by alcohol has increased which has led the local authorities to ban Chinese liquor. The locals in that area also expressed their concern regarding the increasing Chinese presence in the area. Similar social implications were observed in the Chameliya Hydropower project site in Sudurpaschim.

Religious Implications

Religion has been an important determinant to build the cross-border relationship between Nepal and India. India has invested in the religious sector in Nepal to improve the religious tourism between the countries. In 2018, Indian PM Modi pledged IRS 100 crore[36] for the development of Janakpur which is an important pilgrimage site for the Hindus in both Nepal and India and to connect Janakpur with the Ramayana circuit[37].

Similarly, China also has had its fair share of investments in the religious sector of Nepal. In 2011, China announced that it would invest USD 3 billion in the development of Lumbini which included upgrading the airport, building hotels, and constructing a Buddhist university[38]. Lumbini has emerged as a prime location for religious tourism and the tourism industry is estimated to generate around USD 70 billion through its promotion of meditation, yoga, and spa, among others. However, experts have argued that it is more of a strategic decision than a business decision. Since Lumbini is a source of Buddhist religion, it is widely viewed as a way to control Buddhism and also a move to spy on the Tibetan activities in the area.

Furthermore, during the 17th BIMSTEC meeting in Kathmandu in 2017, a special attention was given to promote tourism with a special focus on the Buddhist Tourist Circuit in the area[39].

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36 myRepublica. (2018). PM Modi pledges IRS 100 crore for construction of Ramayan circuit. https://bit.ly/3yqnPsk
37 myRepublica. (2018). Janakpur now a part of ramayan circuit. https://bit.ly/3Ad2aFh
38 Jackson. L. (2019). China is winning the war of Nepal Buddhism. The Diplomat. https://bit.ly/2TzWV9K
39 Information from the website of the Ministry of Foreign Affairs. Retrieved from: https://mofa.gov.np/nepal-and-bimstec/

There have been significant investments in Nepal through Christian missionaries. The Constitution of Nepal prohibits "converting person from one religion to another." Despite proselytizing being illegal, Nepal has the fastest growing Christian population in the world[40]. One of the main reasons could be the political instability within the country which has failed to address the issues of the poor and to a certain extent the void has been filled by the religious aid groups. One of such aid groups active in Nepal is Climbing for Christ (C4C) which is based in New York[41]. The group was also responsible for sending out relief materials and donations during the earthquake of 2015. Some of the other Christian organizations working in Nepal are Himalayan Foundation Nepal (HFN), Mamta Childcare Trust (MCCT), International Nepal Fellowship, among others[42].

C4.4. Security Implications

Since foreign aids and grants are used as a predominant tool for foreign engagement, these can be influenced by donor countries' geostrategic interests. This can have serious security implications for the recipient country. Furthermore, disbursements are also used as a mechanism to pursue their security agendas. According to multiple sources, the USA has been using additional aid as a leverage for Nepal to sign State Partnership Program (SPP)[43]. Similarly, few of the key informants have highlighted that the Postal Highway along the southern districts funded by the Indian government also have hidden motives behind them. According to an informant, *"When we analyze details regarding the engineering of the highway, it is positioned in such a way that it acts as a dam for India while exacerbating the inundation problem at the Nepali side."* However, there is no clear way of knowing the actual motive behind the funding of the postal highway.

FDIs can also pose security threats such as denial or manipulation of access, leakage of sensitive technology or know-how, infiltration, espionage, and disruption[44]. Nepal has a significant amount of investments coming from tax haven countries like St. Kitts and Nevis and British Virgin Island which makes Nepal susceptible to illicit financial flows and money laundering. Furthermore, one of the largest telecommunication companies of Nepal, Ncell is run by a foreign company, which poses the threat of data manipulation and raises questions about data privacy.

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40 Preiss. D. (2016). Why Nepal has one of the worlds fastest growing Christian populations. NPR. https://n.pr/2OrMaVB

41 Ibid

42 https://missionfinder.org/location/nepal/

43 https://nepalkhabar.com/politics/133903-2022-6-13-14-53-43

44 Findings from previous research conducted by CESIF.

According to the International Development Cooperation of 2019 *"Development Cooperation will be mobilized in the areas which do not have any adverse impact - explicitly or implicitly - on sovereignty; national integrity; national interest; religious, ethnic and social harmony; and national security*[45]*"* Furthermore, section 3 of the document also highlights that "International development cooperation will not be sought in the sensitive areas of the nation." However, different I/NGOs working in Nepal are time and again found to be promoting religious agendas which are a threat to national security.

Two of major bilateral partners, India and China have been focusing on cross-border connectivity projects with Nepal. These projects are important in economic integration of the country and will aid in the economic growth through trade and commerce. However, this can also pose different challenges including human trafficking, illegal immigration, goods smuggling among others.

C5. Coordination between FG and PGs regarding FDI

Foreign aid and grants are mainly disbursed through on-budget and off-budget disbursement mechanisms in Nepal. On-budget disbursement implies that the funds are disbursed through the government's budgetary plans. Within the on-budget mechanism, there are on-budget on-treasury which means funds are reported in national budget and distributed through treasury and on-budget off-treasury mechanism which entails that the funds are reflected in national budget and distributed outside national treasury. Likewise, off-budget aids are usually disbursed through the wishes of the donors and are not reflected in the annual financial plan[46]. Since these funds are not reflected in the government budget system, the tracking and disbursement mechanism is not clear.

The grants are disbursed in the provincial level through four types of mechanisms which are federal equalization grants, conditional grants, complementary grants and special grants. Similarly, foreign grants are usually disbursed to PGs and LGs through conditional grant schemes. Thus, the two tiers of government are dependent upon FG for receiving foreign grants[47].

The Ministry of Foreign Affairs sends its liaisons to every province so that the federal government official is present at all meetings between PGs and foreign

45 Information from the official website of the Ministry of Finance. Retrieved from: https://cutt.ly/2KK-jRXA

46 Bhandari. P. S. (2014). Aid on-budget is progressing in Nepal. The Kathmandu Post. https://bit.ly/3b-BIOzs

47 Findings from previous research conducted by CESIF

dignitaries. The decision was also made to ensure that the Diplomatic Code of Conduct is followed by the provincial governments. The Diplomatic Code of Conduct was introduced in 2011 and has not been revised yet. The officials of most provinces are in agreement that provinces should be allowed to have initial deals with the foreign agencies before the final approval is granted by the FG.

According to the International Development Cooperation Policy of 2019, foreign cooperation should be mobilized through NGOs in the projects of national need and priority. Similarly, the policy also entails that the international development cooperation disbursed by the N/INGOs should be made transparent and entered into the AIMS (Aid Information Management System). The Social Welfare Act of 1992 regulates the activities of INGOs in Nepal, while the Social Welfare Council is the main regulating body. According to the law, INGO intending to provide financial assistance does not need to obtain approval however, the NGO receiving the assistance needs approval from the council[48]. Furthermore, provincial government have also endorsed their separate laws that require N/INGOs to report to the respective statutory bodies[49].

Foreign Investment and Technology transfer Act of 2019 provides guidelines for different agencies for overseeing the FDIs in Nepal. As highlighted, the main goal of the act is to *"facilitate the creation of an investment friendly environment to attract foreign investments."* However, the act does not provide any guidelines to define the roles among the different tiers of government in monitoring and evaluating any foreign investments pertaining to their respective provinces. Furthermore, the act also does not address potential national security issues as a result of foreign investments.

Different foreign actors/development partners have their own specific working modalities. Some prefer to work only with FG, while others prefer to work with the FG and LGs[50]. The Swiss Assistance for Provincial Support Program for Province 1 is one of the historic engagements which paved the path for provincial engagement with the development partners[51]. There are certain procedures that the PGs must follow which is outlined in the Standard Operating Procedure (SOP) document. According to a key informant, who has been closely involved with the Swiss Assistance Project, *"Although there are provisions and procedures for provincial engagement with development partners, most people [including PGs and DPs] are unaware about it."*

48 Information from the official portal of the government of Nepal. Retrieved from: https://bit.ly/3Oy-3qac

49 AIN Strategy 2020-2022. Retrieved from: https://www.ain.org.np/page/ain-strategy-2020-2022

50 Information from interviews with experts working in the sector.

51 Information from a press release by the Ministry of Finance. Retrieved from: https://bit.ly/3udafGi

Despite certain progress made in relation to strengthening the coordination between PGs and FGs on the matters of foreign engagement, persistent issues around the articulation of duties and responsibilities between the two tiers of government still remain ambiguous. Furthermore, PGs lack technical capacity to conduct needs assessments to identify big infrastructure and connectivity projects in their respective provinces which further hinders their ability to approach development partners.

C6. Foreign engagements at provincial level

C6.1. Sudurpaschim Province

Status of Foreign Engagement in Sudurpaschim

Sudurpaschim is one of the provinces that shares borders with both India and China. Foreign engagement through bi-lateral and multilateral partners is very limited in the region. Most of the foreign engagements are through multilateral partners in the development cooperation sector.

Another kind of engagement highlighted during the KIIs was through NGOs and INGOs that operate through off the national budget channels. Hence, there is no particular way of knowing how and in what sector these organizations are operating. One of the key informants argued that *"There are different INGOs and NGOs working in the software sector such as skills development and employment. Although these organizations have invested a lot of money in the sector [software], the actual output is very limited."*

Implications of Foreign Engagement in Sudurpaschim

FDI has been important in creating employment opportunities for people in local communities. According to data from the Ministry of Industry, Commerce and Supplies, most of the FDIs coming to Sudurpaschim have been centered in Kailali district. Table 2 below outlines the total FDI investments in the province and total employment generated because of these investments.

Table 2 Total FDI investment in Provinces and employment generated

Fiscal Year	Total FDI (in Rs)	Employment Generated
73/74	13,500,000	115
74/75	682,170,000	533
75/76	N/A	N/A
76/77	550,000,000	115
77/78	N/A	N/A

Source: Ministry of Industry, Commerce and Suppliers

Multilateral partners such as ADB have been working in the infrastructure development sector of the region to build roads and drinking water pipelines which has helped in the economic integration of the region.

One of the major social implications of foreign engagement in Sudurpaschim was seen during the construction of Chameliya Hydropower project in Darchula district. The project was constructed through Chinese investments. In most of the Chinese funded projects, contractors are Chinese which was also true for the Chameliya hydropower project. A key informant who has been working in the field of human rights stated that *"We had a lot of cases of misbehavior from the Chinese employees in the project towards the local people."* Similarly, the project also experienced several delays and took 10 years (7 years more than the scheduled time period) to complete with an additional cost of Rs 10 million[52]. Another key informant highlighted that *"Most of the foreign investments especially Chinese and Indian are made with the intention of earning profit. So, how a certain project impacts the social and environmental aspects of a locality is usually not considered."*

Key informants reported different NGOs and INGOs working in the area without transparency. Furthermore, there are no government regulatory mechanisms to monitor and supervise the activities of these organizations. Through various key informant interviews, it has been highlighted that in the name of aid and relief funds to the poor and vulnerable people, some of the organizations are propagating religious agendas. According to the former Minister of Internal Affairs of Sudurpaschim, lack of transparency regarding the working modalities of these organizations could have serious security implications. Similarly, there are no records of the source of these fundings. Hence, during his/her tenure, auditing process for I/NGOs was initiated, where they had to detail the nature of work at the Provincial ministries. However, the process was not given continuation after ministerial changes. Furthermore, most of the money coming through these organizations are spent on the operational costs and very little trickles down to the local communities.

Perception regarding foreign engagements

Although foreign engagement including foreign aids and investments come under the purview of the central government, most of the provincial leaders at Sudurpaschim believe that they should be able to approach foreign partners on bringing aid and investments. According to a key informant, *"This will also help*

52 Khabarhub. (2021). China investments in Nepal face3 resistance as it harms Nepali interests, benefits only Beijing. https://bit.ly/3nqceTG

in the capacity building of the provincial government." Since foreign engagements have different security implications associated with them, the central government should be at the forefront of all kinds of foreign engagement. On the same note, provincial governments have better knowledge on the types of fundings required for various development activities in their respective regions.

Representatives at Sudurpaschim believe that their province has been largely ignored by the central government. One of the representatives stated- *"We only have one national pride project in our province. This clearly demonstrates where the actual priorities of the central government lie."* Hence, they are more concerned with attracting an adequate national budget rather than foreign grants and investments.

Similarly, there is a general feeling that infrastructure projects through multilateral partners are more successful as compared to the projects through bilateral partners. One of the key informants stated- *"Usually bilateral fundings have different political and strategic aspects associated with them. Furthermore, we have had bad experiences with development projects funded by bilateral partners, especially India and China."*

Two of the important themes echoed by most of the representatives, bureaucrats, and experts in regard to foreign engagements are the need of strong foreign policy and detailed need assessment. A strong foreign policy would entail how to engage with foreign actors and in what capacity. Similarly, a detailed need assessment would give an idea about the kind of infrastructure projects needed and the funding modalities for the identified projects. These would ultimately help to minimize the impacts of vested interests of both bilateral and multilateral partners. However, there is a lack of proper coordination between the central and provincial level governments. Provincial and central governments must adhere to "coexistence, cooperation, and coordination".

C6.2. Madhes Province

Status of Foreign Engagement in Madhes Province

Given the historic proximity and people to people ties, India is dominantly active in Nepal's southern belt. Madhes province has been receiving investment from various INGOs and NGOs, in the sectors of health and education among others. India has been providing small grants to the districts in Madhes Province directly in the sectors like education, ambulance services among others.

Implications of Foreign Engagement in Madhes

Different key informants highlighted that one of the major areas of concern is foreign engagements in the madrasas. Most of the fundings for madrasas come through various NGOs. The details regarding these funding is still unknown. In 2018, Madhes Province (formerly Province 2) introduced a bill allowing foreign funding in madrasas[53]. The bill came under scrutiny because international funding of any kind requires the consent of the central government. Furthermore, various security personnel have highlighted that India has always pressured Nepal to strictly surveil the activities of madrasas. Indian government often perceives madrasas within the sphere of growing Islamic fundamentalism and terrorist activities. However, there are no concrete evidence pointing to terrorist activities linked with madrasas[54].

Provincial representatives believe that the open border between Nepal and India brings some security concerns in the region. Illegal trade, organised crimes, illegal infiltration, goods smuggling, human trafficking are threats regarding the porous border. Different local people have also highlighted that they have faced misbehavior from the SSB (Sashasthra Seema Bal). To address these issues arising from the open border, it is essential for both the provincial government and federal government to look into the security issues, monitor, surveillance and address security threats along the border.

Lack of actual realization of pledged foreign investment is the major economic concern in Madhes province (see Table 3). One such instances is the Indian PM Modi pledging Rs 1 billion. There have been investment commitments in the region but the disbursement of the fund has been very low.

Table 3 Total assistance commitment and actual disbursement

Fiscal Year	Commitment (in USD millions)	Disbursement (in USD millions)
16/17	450.6	18.4
17/18	48.6	66.1
18/19	8.1	67.1
19/20	10.7	14.3
20/21	450.8	11.1

Source: Development Cooperation Reports, MoF

53 Ghimire. B. & Giri. A. (2018). Province-2 allows controversial bill to allow foreign funding for Muslim schools. The Kathmandu Post. https://cutt.ly/ZKXPwCH

54 Findings from the previous studies conducted by CESIF.

Foreign aid and investments in the province will have a greater impact on employment opportunities and also reduce the out-migration of youth, which is a major issue in this province.

Perception regarding foreign engagement

The officials, bureaucrats, business community, and civil society groups in Madhes province have acknowledged the fact that the approval of foreign investment is accomplished through the federal government. It has left the provincial government paralyzed in bringing in new foreign investments themselves as the constitution does not provide any provisions for it. Hence, the federal government and provincial government must coordinate with each other in the priority agendas of the province. It was highlighted that *"the formation of three level of government was to reach closer to the people and address their needs at the provincial and local level. Hence, the federal government has to be attentive towards the need-based agendas of the provincial and local government and cooperate accordingly."*

In relation to the National Pride projects in Nepal, a key informed stated that, Kathmandu-Terai Fast track (KTFT) road project and Nijgadh International Airports (NIA) projects are highlights for the Madhes province. The KTFT project was imagined decades ago, started in 2017 but still has not been completed, when it was set for completion in 2021. The constant delays in the project have prolonged it to 2024, which will require additional investments. The project would have reduced fuel consumption and have directly connected to Nijgadh Airport. Similarly, the recent decision of the Supreme Court to explore alternative options for airport construction comes as an economic setback for the people in the region. A key informant highlighted that, *"Local people want the Nijgadh Airport to start, as it will bring employment opportunities and financial prosperity to the place, so the government has to find alternatives and solutions to the problem"*.

The Chief Minister of Madhes province also highlighted that the construction of Nijgadh airport is a key to the development of the province and that the decision of the Supreme Court is unacceptable. The Madhes government has assured that it has the will to coordinate with the federal government to bring in foreign investments in the province.

Another concern highlighted by a few key informants is the lack of capacity of the provincial government. The lack of sufficient budget has resulted in under staffing which has hampered the capacity of the province to plan and propose development projects to attract foreign investments. This also entails that the province lacks capacity and skills to engage with foreign actors for development

cooperation. There is a need for the transfer of skills and knowledge to develop the capacity in Madhes province.

C6.3. Province 1

Status of Foreign Engagement

After Bagmati Province, Province 1 gets the second highest foreign aid and assistance[55]. Similarly, it also consists of some of the fastest growing cities in the country. The Province Support Program funded by the Swiss government was a landmark project which paved the path for PGs to coordinate with Development Partners prior to seeking approval from the central government. After designing a project through close consultations between DPs and PGs, final approval is needed from the center.

Perception regarding foreign engagements

During the stakeholders meeting at Province 1, most provincial authorities indicated that there is an unfair distribution of foreign aid and grants among the three tiers of government which has hindered the development process. Majority of the foreign aid is centered in Bagmati province. Furthermore, lack of fair and sufficient budget distribution among the provinces has limited their capacity development. Likewise, provincial representatives believe that the centralized thinking of the federal government has hindered the development process at provincial levels. Similarly, lack of concrete modality and framework to deal with foreign investors has discouraged foreign investors in the region.

Province 1 has established a Provincial Investment Authority whose main goal is to promote and mobilize domestic and foreign investments[56]. Similarly, Province 1 has been proactive in identifying areas that require investments. For instance, in 2019, the Chief Minister proposed an ambitious plan on Transmission System Development with multiple hydropower projects.

Like Sudurpaschim, Province 1 shares the border with both India and China. This provides a great opportunity to implement connectivity projects linking India and China. Furthermore, Biratnagar, the capital of Province 1 is one of the largest industrial cities of Nepal. With these two factors in mind, Province 1 can boost its economy which will be further beneficial to cut down the widening trade deficit.

55 Data from Development Co-operation Reports by MoF.

56 myRepublica. (2021). Provincial government successful in creating hope: Province 1 CM Rai. https://cutt.ly/WKJ5HY2

C7. Challenges related to foreign engagement

Understanding vested interest of the development partners

Most of the foreign engagements in Nepal have a stated interest and an actual interest. This is mostly true for bilateral partners. Their main interest for engagement in Nepal is to increase their presence to ultimately counter rivaling influences mainly through economic and geopolitical instruments. Furthermore, multilateral partners are also heavily influenced by the strategic interests of major donor countries. It is often hard to gauge the actual intention of a DPs trying to engage with Nepal. Hence, knowing the actual intention to analyze the benefits and opportunities for the country is a major challenge.

Geopolitical tensions

Over the last few years, increased foreign engagements through MCC, BRI, State Partnership Program (SPP), and high-level visits between the rivaling powers have increased geopolitical tensions in the country. Nepal has mostly maintained good relationships with India, the USA, and China over the years. As the rivalry intensifies, Nepal faces the pressure to engage with them in a neutral manner without risking to hamper the bilateral ties. Along with this, Nepal is also under the pressure to tread the water carefully to not undermine its own national interests in the process. With this changing geopolitical situation in mind, Nepal needs a strong and consistant foreign policy that concretely underlines how it wants to engage with the USA, India, and China.

Aid dependency

One of the key informants explicitly mentioned that *"Development is an industry which has become a money generating mechanism by creating aid dependency."* Aid dependency is a major problem in the context of Nepal. Furthermore, projects that contribute little to nothing in the transfer of skills and knowledge have very limited benefit in the long-term development of the country. In fact, this pushes the country to be more dependent on the foreign technology and expertise for the implementation of development projects and technical know-how. Thus, the government should focus on building internal capacity.

Corruption and lack of transparency

The government has stressed on the need to develop an investment friendly environment to boost the economic growth of the country. Despite the positive attitude, nothing concrete has been formalized to drive the country into that direction. Some of the major drivers of FDI inflow into a country are lack

of corruption and ease of doing business. According to the TI Corruption Perceptions Index, Nepal ranks 117th out of 180 countries[57] and 94th out of 190[58] in the doing business report by World Bank[59]. Furthermore, the process for the approval of foreign investments in Nepal is tedious. According to key informants, *'It may take anywhere from 6 months to 1 year to get the approval from concerned agencies.'* Although the government has started a 'one window policy' for all the foreign investors, to streamline the documentation and paperwork part, there are still questions regarding its efficiency. Apart from creating an environment for investments in the country, it is also important to constantly monitor and evaluate the activities of these institutions.

Addressing security issues

Another challenge for Nepal is to address the security issues associated with different types of foreign engagements. There is a lack of transparency regarding the foreign aid entering into the country through off budget mechanisms. It is evident through various reports and KIIs that different I/NGOs are operating in the country to propagate donor agencies' interests including religion. Thus, monitoring and evaluating the activities of these organizations is essential in protecting Nepal's national security interests.

Threat to social dynamics

There is evidence of changes in social dynamics of local communities due to foreign contractors and workers. People living in close proximity of development projects usually funded by bilateral partners (especially China and India) are more likely to get exposed to different negative externalities such as political capture, corruption, ethnic tensions, and environmental degradation (Dreher et al., 2019). Similarly, our research has also indicated that the major issues are misbehavior towards local people, conflicts, excess alcoholism, and prostitution, among others. These factors undermine social integrity and create social tensions. Thus, it is important for the government to address these challenges that come with the foreign contractors in a development project.

Paradiplomacy and coordination among FG and PGs

Another major challenge regarding foreign engagements is regarding para-diplomacy and coordination between different tiers of government. There lacks a coherence between national foreign policy and pursuit of sub-national

57 Transparency International. (2021). Corruption Perceptions index. https://cutt.ly/kKJ55zA

58 The data is of 2020.

59 Information from the official website of the World Bank. Retrieved from: https://cutt.ly/AKKq4GJ

interests. Similarly, there are no concrete policies to address the issues regarding the pursuit of strategic and security interests by foreign actors at PGs and LGs. Likewise, the challenge to accurately articulate the interests of subnational units while dealing with foreign actors still persists[60]. The lack of coordination between the PGs and FG is evident in the land acquisition process for developmental projects. In Madhes Province, land acquisition has hampered implementation of a couple of proposed development projects.

Gap between commitment and disbursement

There is a vast difference between the committed aid and the actual aid disbursed. Table 4 below outlines the details of differences in the announced and actual ODAs in the study provinces.

Table 4 Gap between aid commitment and disbursement

FY	Madesh Province		Sudurpaschim Province		Province 1	
In USD millions	Commitment	Disbursement	Commitment	Disbursement	Commitment	Disbursement
16/17	450.6	18.4	10.5	17.5	4.3	15.02
17/18	48.6	66.1	18.4	58.8	171.3	56.3
18/19	8.1	67.1	177.8	43.3	11.9	27.6
19/20	10.7	14.3	N/A	54.9	16.5	95.8
20/21	450.8	11.1	13.1	40.8	N/A	14.3

Source: Ministry of Finance

The figures could possibly be attributed to Nepal's low internal absorbent capability in the design of donor-funded initiatives, as well as limited capacity in implementation. The data also shows that the commitments of the donor have been by far more than the disbursement, and that donor commitments have varied significantly from year to year over the last decade. The unpredictable political situation and low compliance with donor aid preferences and regulations and adherence to donor conditions, are likely to have an impact on both donor commitments and low disbursements.

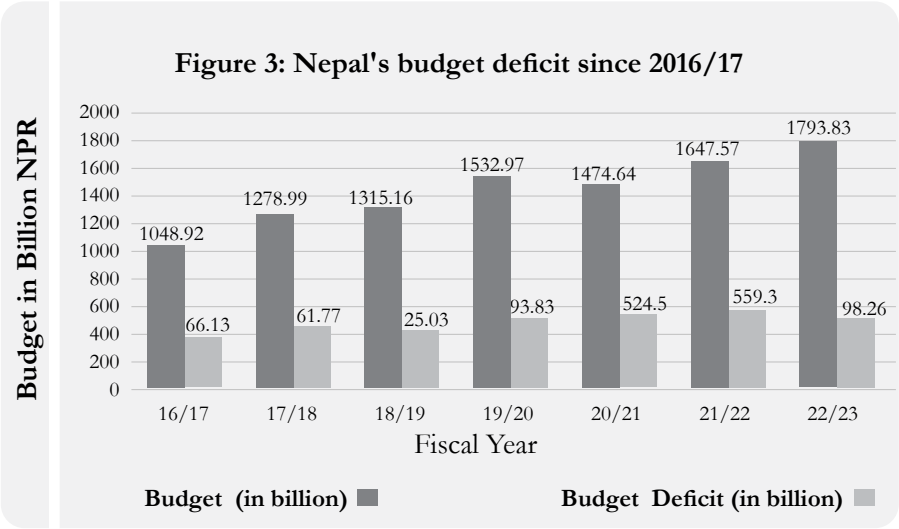
The government needs to facilitate the inflow of committed ODAs and approved FDIs to reduce the gap between approved/committed and actual/disbursed commitments. Similarly, foreign investments should be utilized towards facilitating local industries to narrow the trade deficits.

60 Findings from previous research conducted by CESIF.

C8. Opportunities of foreign engagements in Nepal

Gap in Development Funding

Nepal is always on the budget deficit as internal revenue is not enough to meet the national expenditures (see figure 3). The budget deficit for FY 22/23 stands at Rs 498.26 billion. This deficit is expected to be filled by foreign aid and grants. The required borrowing by the government on average is seen to be around Rs. 500 billion. The government requires to fill in the funding gap by seeking out various opportunities by reducing trade barriers which provide access to foreign markets, promote ODA, attract FDI, increase revenue generation from domestic resource mobilization and increase both domestic and foreign investment in industries and increase engagement with bilateral, multilateral partners and development finance institutions.



Source: National Planning Commission

Nepal has prepared its national SDG (Sustainable Development Goals) targets in line with the global targets to end poverty and protect the planet. According to the report prepared by the NPC, the financial gap to attain the ambitious SDGs set by Nepal for the period between 2016-2030 stands at around Rs 8,775 billion (See Annex 3). Furthermore, the report highlights that the total cost required to achieve these goals is Rs 30,384 billion, of which Rs 13,396 billion is expected to come from public investments and foreign aid/grants[61]. These data indicate that ODAs and FDIs play an important role in filling the financial gap for budget deficit and meeting the SDG targets, among other expenditures.

61 NPC. (2018). Needs Assessment, Costing, and Financing Strategy. https://cutt.ly/WKKwcLh

Opportunities for Regional Cooperation

As Nepal is a landlocked country, the importance of regional connectivity for economic development cannot be ignored. Nepal is a member of SAARC, BBIN, BIMSTEC, and WTO and has bilateral ties with 176 countries[62]. By expanding cooperation through these channels, Nepal can increase connectivity and trade opportunities. Currently, Nepal has higher imports than exports, it is essential that the country utilizes various agreements through these regional institutions to receive greater benefits in trade. Nepal is a party to the SAFTA agreement, to ease trade barriers between the SAARC nations. The members of SAARC also signed the SAARC Agreement on Trade in Service (SATIS) in 2010[63]. Nepal primarily being an import-based economy has not been able to take advantage of these provisions and facilitate export.

Nepal has exceptional potential in energy production which can be exported to countries beyond India, which will help decrease reliance on India regarding trade facilitation. Through regional cooperation under BBIN, India and Nepal have come to an agreement on cooperation in the energy and power sector to further expand the trade[64]. After the 4th Summit of BIMSTEC in 2018, MoU was signed for the integration of Grid interconnection for energy cooperation in the region[65]. Nepal can utilize the agreement for expanding energy trade to the energy-hungry nations in the region.

BIMSTEC and prospect of cooperation beyond Bay of Bengal

BIMSTEC would be an opportunity for Nepal to connect to the regions beyond the Bay of Bengal, further to the southeast Asian regions[66].Through the regional mechanisms, Nepal could be able to access the ports of Bangladesh and expand its trade to other nations taking advantage of arrangements conducted under the BIMSTEC Free Trade Area Framework Agreement[67]. The connectivity of the countries within the regional cooperation will also help in the upliftment of tourism sector of Nepal, attracting Buddhist tourists from Myanmar, Laos, Thailand and Sri Lanka[68].

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62 Information from the website of the Ministry of Foreign Affairs. Retrieved from: https://cutt.ly/uKKwTGz

63 Information from Nepal Trade Information Portal. Retrieved from: https://cutt.ly/lKKwVXz

64 Giri. A. (2022). Nepal, India agrees to expand power cooperation under BBIN framework. The Kathmandu Post. https://cutt.ly/CKKpJCc

65 Information from Ministry of External Affairs, Government of India. Retrieved from: https://cutt.ly/zKKaayp

66 Jaiswal. P. (2020). Exploring the BIMSTEC potential: Opportunities, Challenges, and way forward. NIICE. https://niice.org.np/archives/4905

67 https://www.newbusinessage.com/Articles/view/13098

68 Nayak. S. (2022). A new year for India and Nepal: Can BIMSTEC be the key?. ORF. https://cutt.ly/JKKaCSf

Cross border connectivity and Tourism

Tourism has a paramount impact on a country's socio-economic development, and is Nepal's 4th largest industry for employment[69]. Top Five countries of nationality to arrive in Nepal are India, Myanmar, Thailand, China, and the USA respectively in the 2020 report (MOCTOC, 2020)[70]. Comparatively, the inflow of Chinese tourists and its ranking in the top countries for the arrival of tourists in Nepal has fallen. Hence, an increase in cross-border connectivity with our northern and southern neighbors can have a greater impact on tourist inflows in the country which will help improve the economy. Even the road connectivity through belt and road initiative has possibilities to attract tourists, not only cross-border but throughout the south-Asian region[71].

Cross-Border Electricity Trade

India and Bangladesh are two of the biggest markets for electricity export. Nepal and India had signed an agreement for cross-border electricity trade in 2014 through transmission interconnectedness. The agreement entailed that *"it will enable cooperation in the power sector, including developing transmission interconnections, grid connectivity, power exchange and trading through the governmental, public and private enterprises of the two countries on mutually acceptable terms "*[72] However, only after 6 years of signing the agreement, Nepal actually started exporting electricity to India. The Ministry of Energy, Water Resources and Irrigation highlighted that India has approved Nepal to trade in Indian Energy Exchange Limited (IEX) for 39 MW electricity (24 MW from Trishuli Hydropower project and 15 MW Devighat Hydropower Project)[73].

Similarly, India's Manikaram Power Limited and Nepal Power Exchange Limited signed a MOU on power trading. Further, Nepal proposed India to sell electricity produced from the Upper Tamakoshi Hydropower Project[74]. Moreover, paving the way for private sectors to enter the energy market will assist the government

69 Prasain. S. (2021). Tourism is Nepal's fourth largest industry by employment, study. The Kathmandu Post. https://cutt.ly/9KKstdb

70 Information from the Tourism Department of Nepal. Retrieved from: https://cutt.ly/pKKshSG

71 Rijal. P. (2019). Nepali and Chinese officials stress road connectivity to boost tourism arrivals from China. The Kathmandu Post. https://cutt.ly/sKKsBjd

72 Agreement between Nepal and India retrieved from: https://bit.ly/3tTfOd1

73 Press Release by the Ministry of Water Resources and Irrigation retrieved from: https://bit.ly/3NvX-Vch

74 OnlineKhabar. (2021). Government preparing to let the private sector also trade electricity. https://cutt.ly/6KKdFeM

in accumulating more revenue for the country. Thus, the government is now considering letting the private sector be involved in power trade[75].

With the cooperation of bi-lateral partners on transmission lines, Nepal can increase it's power trade capacity, such as MCC granting fund to build 400kV transmission line, and China-Nepal collaboration to conduct a feasibility study to build power transmission lines along the Himalayas to assist in power trade[76].

Cross-Border Trade

Though imports and exports have both increased, the gap between the two has also widened over the years. According to the data from the Department of Customs, the trade deficit for FY 18/19 and 19/20 are Rs 1321 billion and Rs 1099 billion[77]. One of the main reasons for this widening trade deficit is lack of road infrastructure and connectivity[78]. Furthermore, Nepal's trade has been mainly dependent on India. On the other hand, trade with China has been limited due to geographical constraints. Similarly, other barriers to cross-border trade faced by Nepal are low security of goods, lengthy time for processing and issuing origin certificates, lack of capacity and adequate personnel, and lack of proper coordination between different agencies. Furthermore, agricultural goods which are perishable constitute the major portion of Nepal's exports. Due to the lack of storage facilities have made it difficult for traders to export goods[79].

Nepal being an agriculture based country, promoting agriculture in the country can have greater output in trade and revenue generation. Agro-production and trade can be facilitated by attracting the global value chain to Nepal or increasing competitiveness among the domestic businesses for quality productions, attracting FDI to invest in technologies, infrastructure, and other requisite for agricultural development.

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75 OnlineKhabar. (2021). Government preparing to let the private sector also trade electricity. https://cutt.ly/6KKdFeM

76 OnlineKhabar. (2021). Government preparing to let the private sector also trade electricity. https://cutt.ly/6KKdFeM

77 Sharma. G. (2022). China and Nepal study feasibility of cross-border power grid. Reuters. https://cutt.ly/WKKfWpu

78 Information from the official website of the Customs Department. Retrieved from: https://cutt.ly/KKKfXg2

79 ADB. (2020). Economic impact analysis of improved connectivity in Nepal. https://cutt.ly/yKKgeia

According to a World Bank report, Nepal has an untapped export potential of USD 9.2 billion[80]. Hence, to realize this potential Nepal must focus on two major things: strengthening cross-border connectivity; and strengthen the capacity and resources of local businesses, to take full advantage of duty concessions and tariffs provided through bi-lateral and multilateral treaties.

D. ANALYSIS AND CONCLUSION

Interests and Motivation of Foreign Actors

Countries around the world have been increasingly using economic diplomacy as a means of foreign engagement. Multilateral and bilateral partners state that their major motivation for engagement in Nepal is to help the country in its developmental path. However, due to Nepal's strategic geographical location between two of the major global powers India and China, most of the foreign actors have vested interest for their engagement in Nepal. For some engagements the hidden motives are clear, while for others it is difficult to understand. For instance, in the case of the USA, it is clear that one of the main reasons for their engagement is to promote stability in some of the most vulnerable parts of the world which would ultimately protect America's security interests. Furthermore, the data suggests that it uses foreign aid and grants as a way to create employment opportunities for its citizens. Likewise, the USA uses its engagement in Nepal to keep a close eye on Chinese activities across the border.

The political interests are clear in the engagement of India and China. Both the countries use aid/grants and investments in Nepal as a way to counter each other's presence in the country. China's major interests include economic interests, strategic interests, and increasing its influence in the South Asia region. The strategic interests entail surveilling Tibetan refugees, and diminishing Western influence in the country. Like China, India is also mainly concerned with increasing its influence in Nepal. On the other hand, multilateral partners such as The World Bank promote strategic interests of the USA, who is also its largest financier. However, such engagement of multilateral partners in Nepal is not clearly visible. Multilateral partners have been engaging in both hardware and software sectors of Nepal. But their engagements have slowly started shifting towards the software sector which are also used to assist/influence policy making of the country.

80 World Bank. (2021). Export competitiveness key to Nepal's green, resilient, and inclusive recovery, states new World Bank
report. https://bit.ly/3pF5YJ7

Implications of Foreign Engagement in Nepal

Foreign Engagements have both positive and negative implications for Nepal. It is important for the government to detail both positive and negative implications and to push for minimizing the negative externalities whilst promoting the positive aspects associated with them. Nepal's strategic geographic location poses a serious challenge for the country to engage with the foreign actors in a balanced manner. To promote balanced engagement with foreign actors, it is important to not entail any preferential treatment and adhere to its non-alignment and neutrality position. Similarly, it is important for the government to carefully analyze each situation to understand the hidden motives and interests of the foreign actors to make an informed decision.

Foreign aid and investments have played an important role in the economic growth of the country by creating employment opportunities and facilitating infrastructure development projects. However, they have also created aid dependency. Foreign aid and grants are an important part of the national budget. One of the main reasons for this continued aid dependency is the lack of technology and knowledge transfer from the DPs. For instance, most of the Chinese funded projects have Chinese contractors to implement the project. So, the skills and knowledge related to implement a project is not transferred to the local people, which hinders the development aspirations of the country in the long run. Similarly, another important factor associated with foreign loans is debt vulnerability. Although a report by ADB has highlighted that the risks associated with debts are low for Nepal, few bad loans change that scenario. The debt has been gradually increasing over the period of time. Nepal owes most of its debts to the multilateral partners including ADB and the WB.

There are also different socio-religious implications of foreign engagement in Nepal. Social dynamics have been impacted in the project areas implemented by international contractors and laborers, especially Chinese. This creates a heterogeneity in the society with different ethnicities which can further lead to social tensions. The Chameliya hydro project in Sudurpaschim along with other projects in Rasuwa are examples of impact on the social dynamics of the communities in these areas. These places have experienced extreme cases of alcoholism, prostitution, misbehavior and dominating attitude towards local people from the foreign project employees.

Both India and China have invested in the religious sector of Nepal. Likewise, different I/NGOs are also discreetly operating to promote religious agendas. Since vulnerable communities are being widely ignored by the government, these I/NGOs have used aid as an incentive to propagate their religious agendas in these communities. Furthermore, lack of monitoring and supervision of these organizations by the government has also helped exacerbate this issue. The social issues related to development projects persists because of the lack of SIA (Social Impact Assessment). If the government was to prioritize SIA, it would help them identify the potential impacts of a project on social aspects and provide mitigation measures to address these potential impacts.

As discussed earlier, each foreign actor has its own vested interest. While DPs promote their own security agendas through different economic tools, the government needs to make sure that Nepal's security is not undermined.

Working Modalities of Foreign Actors

Foreign aid/grants are mainly disbursed through on budget on treasury, on budget off treasury, or off budget mechanisms. If they choose on-budget off-treasury, the aid is disbursed through the national budget, but they will be responsible for procurement and contracting of the development project. A DP often chooses this modality, if they have questions about the government's ability to provide technical assistance by maintaining transparency throughout the entirety of the project. Likewise, if the aid is disbursed through the on-budget on-treasury, it entails that a DP is fully confident in the government's ability to entirely complete the project. Finally, off budget disbursements are not recorded in the national budgetary system and the inflow of these within the country are not transparent, atleast in case of Nepal.

Similarly, as per the guidelines provided by the Standard Operating Procedure (SOP), foreign actors can either use top-down or bottom-up approaches. A top-down approach means DPs engaging directly with the FG, while bottom-up approach means direct engagements with PGs and finally seeking approval from the FG. Since most of the PGs lack capacity and technical skills, most of the engagement takes place at the central level. Recently, DPs have started using a bottom-up approach, as indicated by the Province Support Program at Province 1 initiated by the Swiss agency. Bottom-up approach is beneficial to the PGs for capacity building and leadership. Despite different approaches used by DPs or foreign actors, foreign engagement of all kinds falls under the purview of FG.

Coordination between PGs and FGs

The Standard Operating Procedure (SOP) put forth by the Ministry of Finance (MoF) has provided a set of procedures through which DPs can engage with PGs or FG as per their need. The engagement of the Swiss government at provincial level paved the path for this. However, most PGs are unaware about this procedure due to a lack of coordination and communication between the two tiers of government. Similarly, most DPs are also unaware about this standard procedure.

Different acts and policies including Development Cooperation Policy of 2019, Foreign Investment and Technology Transfer Act of 2019 have provided the framework for different kinds of foreign engagements in Nepal. However, these do not clearly specify the roles of PGs in the process. Most of the representatives at provincial level believe that PGs should also have a role to play to facilitate foreign engagements which would also be beneficial in their capacity building. Furthermore, better coordination would allow the PGs to identify areas in their respective provinces that would benefit the most through foreign aid or investments.

Foreign Engagements at Provincial Level

In Sudurpaschim Province, the instances of foreign engagement are limited. However, there are different I/NGOs operating mostly in the software sector. One of the major implications of foreign development projects was seen in the case of the Chameliya hydropower project in Darchula district. The temporary migration of Chinese workers had negative impacts on the social dynamics of the local communities. One of the main reasons for this could be the lack of focus on the government's part to conduct a detailed SIA to mitigate some of these social issues. Similarly, lack of transparency regarding the working modalities of different I/NGOs in the region was identified as the major security concern. There are no concrete policies and laws to monitor and supervise the activities of these organizations. There is a lack of knowledge regarding the kind of work they are doing and its impact on the communities. Apart from that, the data indicates that most of the FDIs in Sudurpaschim are centered around Kailali district which has helped create employment opportunities for the people in the area. The provincial representatives have highlighted that coordinating with FG in the matters of foreign engagement is not their top priority. There is an overwhelming sentiment among the representatives at Sudurpaschim, that their province has been largely ignored by the FG. So, they want to move ahead through coordination, coexistence, and cooperation with the FG in all matters.

Like Sudurpaschim, Madhes province also feels a sense of alienation from the central government. Thus, to fill this gap, there is a need for coordination and cooperation among the tiers of government to identify priority agendas in investment, security and other demands of the provincial government regarding the FDI and ODA disbursed at provincial levels. Furthermore, provincial representatives believe that national budget disbursement at Madhes province is low and inadequate for the implementation of development projects. They are in agreement that they should be allowed to approach foreign investors in their province. There is also a sense of discontent towards the central government due to the collapse of a few foreign projects as a result of lack of coordination between the two tiers.

As compared to Sudurpaschim and Madhes provinces, there are significant foreign engagements at Province 1. One of such projects is the Provincial Support Program (PSP) which was initiated through the coordination between the Swiss government and federal government of Nepal. This project was also significant because the Swiss government directly coordinated with the provincial government in developing the framework of the program as per the need of Province 1. As highlighted by a key informant who is closely involved in the project, this project became a basis for foreign engagement at provincial level by following the SOP. One of the major issues with provincial governments is lack of skills and knowledge to engage with foreign actors. However, this issue was less pertinent in Province 1. Provincial representatives believe that there are different opportunities for foreign investments in the region which requires proper coordination with the central government.

Opportunities and Challenges

Foreign engagements come with different challenges for the government to deal with, but they also present Nepal with opportunities for regional cooperation and economic development. One of the major challenges for the government while engaging with foreign actors is escalating geopolitical tensions which surface as a result of vested interests of these actors. This can further impact the long-standing bilateral ties among different countries. Nepal's internal political dynamics has always shaped its foreign policy. Furthermore, experts have argued that Nepal's foreign is ad hoc and lacks short term and long-term goals[81]. Due to the lack of concrete foreign policy, Nepal has always faced issues on balancing these three big powers. The engagement of foreign actors (both multilateral and bilateral) can undermine the national interests. National policies

81 Baral. L. K. (2021). Nepal's foreign policy failure. The Kathmandu Post. https://cutt.ly/JKKgDNg

and foreign policies both go hand in hand and should complement each other. Most of the current issues arising from foreign engagement is a result of gaps between domestic policies and foreign policy.

Nepal has immense potential for hydropower and tourism sectors. To realize this potential, Nepal has to build better connectivity with its northern and southern neighbors. Nepal being a landlocked country, it is important for it to realize the importance of regional connectivity to fulfill its development aspirations. Hence, it has to look beyond the India-China sphere. The regional cooperation through BBIN and BIMSTEC opens the door to other potential markets. Nepal also needs to realize the opportunities of international infrastructure projects, such as MCC and BRI to fulfill its quest for development.

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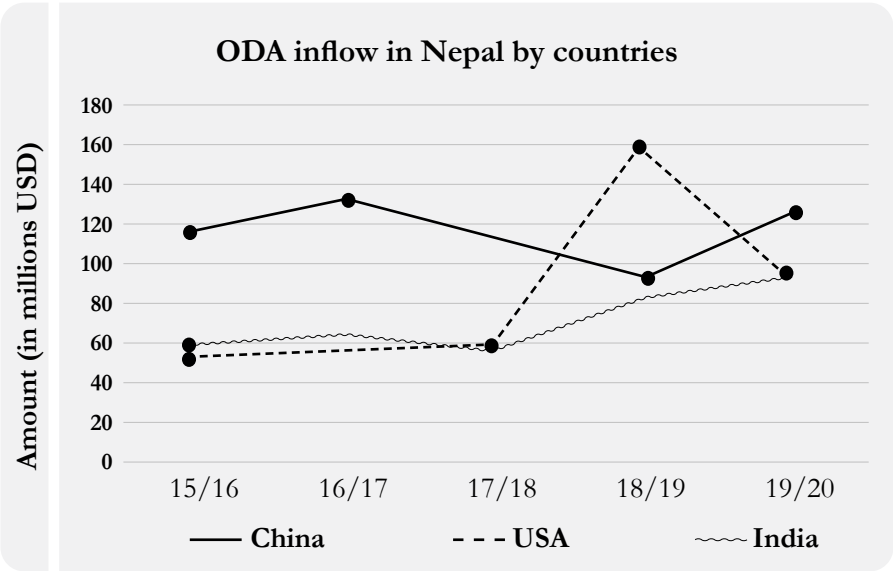
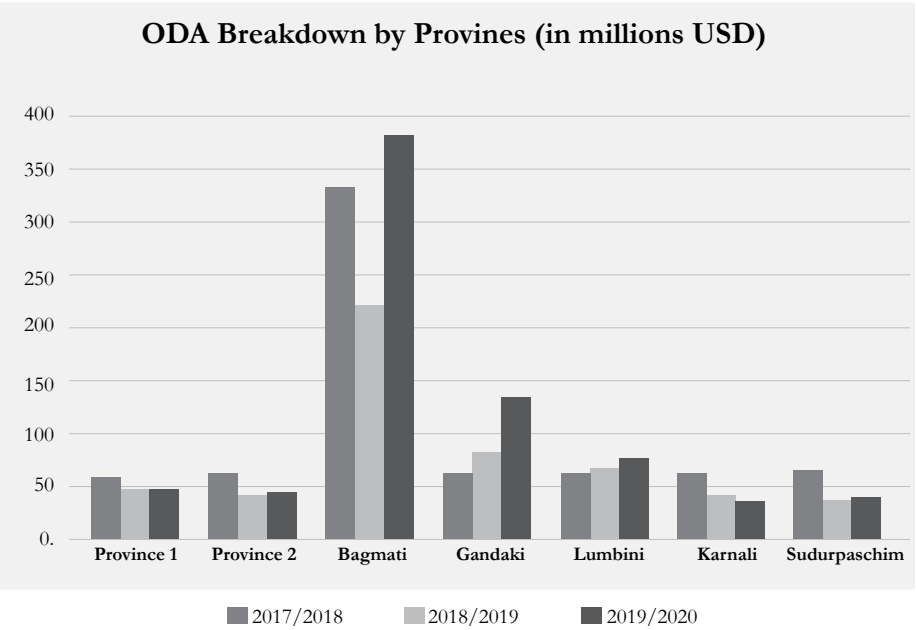
ANNEX

Annex 1: ODA inflow in Nepal



Annex 2: ODA breakdown by provinces



Annex 3: Average Annual requirements for meeting SDGs targets

(Unit: Nepali Rs in billion, at constant price of 2015)

Description	2016-19	2020-22	2023-25	2026-30	2016-16
Total SDG Investment Need	1,055	1,559	2,046	3,070	2,025
Total SDG Investment Need (inUSD at constant price of 2015)[1]	10.25	15.14	19.87	29.82	19.68
Total SDG Investment Need as % of GDP	43.8	48.8	48.8	49.7	47.8
Private Investment requirement	259	443	736	1303	739
Private resource available (In FDI)	224	333	418	488	373
Private finance gap	35	110	318	815	366
Public Investment requirement	702	979	1134	1505	1111
Public resource available (including ODA)	521	698	905	1300	893
Public finance gap	181	281	229	205	218

source: Nepal Planning Commission

Chapter 2

Geopolitics and Infrastructure Development in Nepal's Federal Context

Ajaya Bhadra Khanal

A. BACKGROUND AND CONTEXT

A1. Background

This research report focuses on the intersections of (a) geopolitics and foreign affairs, (b) cross-border connectivity and infrastructure development, and (c) FDIs and development finance. In particular, it looks at the policies, practices and attitudes (perceptions) of federal government as well as the provincial governments. It also looks into key political economy dynamics around the above-mentioned issues.

A2. Context

Agenda of Prosperity

Along with the implementation of the new constitution and institutionalization of democracy, governments at various levels in Nepal are currently engaged in driving the agenda of prosperity. Policies and programs of almost all governments (federal, provincial and local) have placed the agenda of prosperity at the front and center. However, Nepal currently faces a financing gap of Rs 585 billion per year if it is to meet the Sustainable Development Goals (SDG)[1].

Geopolitics

Geopolitical competition at the international level as well as renewed hostilities between India and China has a direct impact on politics and policy environment at the federal and provincial levels. Nepal's interests in pursuing infrastructure development, connectivity and foreign direct investment have intersected with the strategic interests of great and emerging powers. During conversation,

1 Shrestha, P. M. (2019, November 7). Why has Nepal failed to attract enough foreign direct investment? The Kathmandu Post. https://kathmandupost.com/money/2019/11/07/why-has-nepal-failed-to-attract-enough-foreign-direct-investment

senior political leaders[2] cite geo-politics and foreign actors as the major factors that influence Nepal's governance and policy-making.

Security dilemma

Competition at the international level between great and emerging powers as well as renewed hostilities between India and China have become an additional matter of concern for Nepal even as it seeks to pursue development cooperation and projects of connectivity. The National Security Policy 2075 outlines several critical threats linked to geo-politics including blockades, treaties that do not serve national interests, unregulated migration and distribution of citizenship, secessionist activities, and threats generated by geopolitical rivalry.

Para-diplomacy[3]

The federal government in Nepal reserves the right to conduct and coordinate foreign affairs. However, in order to promote their own interests, sub-national actors in Nepal frequently take part in negotiations and consultations with donors, inter-governmental agencies and foreign actors regarding issues like strengthening of federalism, economic development, investment, and environment and climate change. At the same time, both India[4] and China have given some leeway to the provinces and states to pursue national foreign policy interests, which means that Nepal and its subnational units will need to develop policies and capacity to engage with individual Indian States or Chinese Provinces in order to manage trans-border relations in areas like trade, connectivity, infrastructure, security, environment and natural resource management. In addition to federalism, projects of cross-border connectivity, foreign investments and cross-border relations have become new areas of focus in the study of para-diplomatic action[5].

Development partners and initiatives

In order to pursue its development aspirations, Nepal is relying on its development partners (eg, US, China and India), regional groupings (SAARC/

2 Conversation with Ishwar Pokharel, Bimalendra Nidhi, and Pradeep Gyawali.

3 Paradiplomacy studies the capacity and role of subnational units in pursuing their interests through international relations. See Wolff, S. (2007). Paradiplomacy: scope, opportunities and challenges. The Bologna Center Journal of International Affairs, 10(1), 141-150.

4 For a quick review of paradiplomacy in India, See Tewari, F. (2017, August 21). Paradiplomacy in India: Evolution and operationalisation. Observer Research Foundation. https://www.orfonline.org/research/paradiplomacy-india-evolution-operationalisation/

5 See Kuznetsov, A. (2014). Theory and practice of paradiplomacy: Subnational governments in international affairs. Routledge. Also see Bursens, P., & Deforche, J. (2010). Going beyond paradiplomacy? Adding historical institutionalism to account for regional foreign policy competences. The Hague Journal of Diplomacy, 5(1-2), 151-171.

BBIN/BIMSTEC), international financing arrangements (eg, BRI, MCC) and foreign direct investments. The US, in particular, is working with G7 nations on the Build Back Better World initiative, which is linked to strategic competition with China and the infrastructure needs of low- and middle-income countries[6].

Multiple challenges

There are other multiple challenges facing Nepal in its quest for geo-strategic balance, cross-border connectivity and infrastructure development. There is currently a lack of policy-relevant and evidence-based political economy analysis of policies and practices around cross-border relations, cross-border connectivity, infrastructure and development finance. Although the federal and provincial governments are shaping policies and practices to engage with foreign entities and processes, there is little documented information about their experience and the dynamics their policies and practices have generated.

At the same time, hidden actors and interest groups are engaging with emerging and geopolitical dynamics to promote their own interests, which frequently undermine national and public interests. Nepali people know a lot about cross-border relations with India, but have little information or debate about cross-border relations with China. Lack of evidence-based data has given rise to proliferation of fake information and alternative narratives that harm national interests.

B. DESCRIPTION OF THE RESEARCH PROJECTS

B1. Research Objectives and Key Research Questions

The objective of this study is to better understand the political economy of cross-border infrastructure and infrastructure development at the federal and provincial levels. This includes information about current policies, practices, and attitudes (perceptions) about geo-politics, BRI, South Asian regional initiatives, projects of connectivity (cross-border infrastructure), infrastructure, development cooperation and foreign direct investment.

The research explores the question, what kinds of formal (legal) and informal norms and practices exist at present to guide (a) geopolitics and foreign affairs, (b) infrastructure development and cross-border connectivity, (c) FDIs and development cooperation? The second key question is: What are the key obstacles and challenges to achieving priority goals and objectives in these sectors?

6 House, T. W. (2021, June 16). FACT SHEET: President Biden and G7 Leaders Launch Build Back Better World (B3W) Partnership. The White House. https://www.whitehouse.gov/briefing-room/statements-releases/2021/06/12/fact-sheet-president-biden-and-g7-leaders-launch-build-back-better-world-b3w-partnership/

B2. Rationale, assumptions and significance

If there is (a) transparency of governments' policies, practices and attitudes relating to projects of connectivity and development involving foreign actors and foreign investment, (b) well-documented information and analyses about the social, political, economic and security dynamics of foreign engagement, geopolitics and cross-border relations at the federal and provincial level, and (c) if these information and analyses are communicated effectively, then it will help the civil society and the governments shape better policies and practices to safeguard and promote Nepal's national interests (democracy, openness, economic development, independence, justice and equality, rule of law). This, in turn, will also contribute to regional peace and security.

If Nepal is unable to balance its national interests, maintain smooth cross-border relations, and engage with geopolitical actors in a transparent and predictable manner, it is likely to lead to political instability and regional conflict. Studies like this are required to contribute to greater level of accountability and transparency in Nepal's foreign relations, projects of cross-border connectivity, infrastructure and development finance at the provincial and federal levels. Smooth implementation of projects of infrastructure development, development cooperation and (regional) connectivity depends on the quality of cross-border relationship, level of trust, public confidence and protection of national/security interests.

Given Nepal's social and political environment, evidence-based policy proposals are frequently trumped by hidden interests and incentives of key actors and decision-makers. Therefore, the generation of evidenced-based policies alone is not enough to improve the policy environment or generate better policies and practices. The required change requires a better understanding of political-economy related factors of influence and a network of an informed civil society and change makers prepared to act on that knowledge in order to promote national interests.

This study assumes that *geopolitical dynamics can have a significant impact on governance and society.* Geo-political dynamics can have a significant impact on Nepal's political-economy and the country's ability to pursue national interests (particularly sustainable development, open society, equality, democracy, and independence). The poor and marginalized populations, both in the hills and the Terai, are most affected by these dynamics.

Another assumption is that *question of transparency and conflict of interests is another major challenge to fulfilling national objectives.* Hidden incentives and interests of

different stakeholders/actors can undermine national/security interests, create conflict of interests, and hinder Nepal's democracy and development. Nepal needs to adopt a transparent, informed and trusted process on the basis of which it can engage with development partners, foreign actors and regional/ global initiatives to promote national and public interests.

Strategic and Security Interests also play a significant role. Engaging in regional connectivity and development cooperation almost always has implications for a country's strategic and security interests. Nepal needs to develop capacity to balance its national and strategic interests while pursuing foreign policy, projects of regional connectivity, development cooperation, and foreign-direct investments.

B3. Research Methods

This research is primarily based on interviews with key informants at the federal and provincial levels, review of literature, and three interactions with stakeholders at the province level in Province 1, Madhesh Pradesh and Sudurpaschim Pradesh (which included province-level political leaders, chief ministers, government officials, civil society members).

C. SUMMARY OF KEY FINDINGS

C1. Some legal instruments and formal norms

The major policy or legal instruments around foreign affairs, development cooperation, infrastructure development and cross-border connectivity include (i) the Constitution of Nepal, (ii) Foreign Policy 2020, (iii) Foreign Investment and Technology Transfer Act 2019, (iv) the International Development Cooperation Policy 2019, and (v) The National Security Policy 2018.

Constitution of Nepal 2015

The Constitution of Nepal frames Nepal's foreign policy as well as relations between the federal government and the provincial governments. The relationship between the provinces and the federal government is guided largely by the constitution, but certain aspects of the relationship are contested, with the provinces claiming that the federal government has refused to hand over powers that the constitution has assigned to the provinces.

Regarding foreign policy, the Constitution outlines Nepal's national interest (Article 5.1): *"Safeguarding of the freedom, sovereignty, territorial integrity, nationality, independence and dignity of Nepal, the rights of the Nepalese people, border security, economic well-being and prosperity shall be the basic elements of the national interest of Nepal."*

Similarly, Article 50-4 directs international relations towards *"enhancing the dignity of the nation in the world community by maintaining international relations on the basis of sovereign equality, while safeguarding the freedom, sovereignty, territorial integrity and independence and national interests of Nepal."* The State Policy (Article 51) further specifies the foreign policy of the state.

Foreign Policy 2020

The policy was issued during Prime Minister K P Oil's tenure and emphasized Nepal's "independent" foreign policy, a terminology that came to represent Nepal's eagerness to move away from Indian influence and one that was seen as being favorable for China. For many reasons, Nepal's Foreign Policy document is contested across party lines. The Policy tried to adapt Nepal's foreign policy based on the changing aspects of foreign policy saying *"national priorities, international, regional and geopolitical changes and the new power balance generated by these changes can influence foreign policy (MoFA, 2020)."* Among others, the policy also specified the need to protect national interests and to accept international development assistance by ensuring Nepal's national interests. The main goal of the foreign policy was to *"promote overall national interests by strengthening external relations based on sovereign equality, mutual benefit and respect through operation of an independent and balanced foreign policy (MoFA, 2020)."*

Despite the issuance of a foreign policy, there is little consensus among Nepal's largest political parties regarding international relations. As a result, Nepal's foreign policy is ad hoc and based on immediate political and partisan interests of top political leaders.

The Foreign Investment and Technology Transfer Act 2019

It aims to *"make national economy competitive, strong and employment-oriented through mobilization to the maximum extent of the available means and resources for economic prosperity of the country, and to achieve sustainable economic growth through industrialization while creating investment friendly environment to attract foreign capital, technology and investment in the sectors of import substitution, export promotion, through increase in productivity, and of infrastructure development and production of goods or services."*

Despite opportunities and prospects—for example, in hydropower, agriculture, tourism, the ICT sector and infrastructure—Nepal has been unable to attract foreign direct investments in a meaningful way. As of 2019, Nepal's

7 World Bank. (n.d.). TCdata360 - Open Trade and Competitiveness Data. The World Bank. https://tcdata360.worldbank.org/

foreign direct investment was USD 185.6 million or 0.54% of the GDP.[7] According to a US government report, the primary reasons deterring potential investment are *"political instability, widespread corruption, cumbersome bureaucracy, and inconsistent implementation of laws*[8]*."* Conflicting political interests and red tape, for examples, deterred the development of a joint-venture project, the Huaxin Narayani Cement and created hurdles for many others.[9] Many other sectoral laws and policies, e.g, Industrial Enterprises Act 1992, Electricity Act 1992, Nepal Petroleum Act 1983 also affect the FDI environment.

International Development Cooperation Policy 2019

International Development Cooperation Policy is a more effective instrument that guides development cooperation and development financing. Nepal is pursuing international development cooperation to achieve sustainable economic growth, and to graduate to a middle-income country status by 2030. The policy seeks to synchronize mobilization and management of development cooperation with the federal governance structure. The policy lists, physical infrastructure as an area of top national need and priority. Development cooperation policy intends to address *"the development needs of all the tiers of the government."* According to the policy, *"the sectors for mobilization of international development cooperation will be selected on the basis of provincial and local development plans" as well as "on the policies and programs to be declared periodically by the Government of Nepal."*

Policy framework article 3.1.4 says international development cooperation should not *"have any adverse impact—explicitly or implicitly—on sovereignty; national integrity; national interest; religious, ethnic and social harmony; and national security"* while article 3.1.5 says cooperation will not be sought in the *"sensitive areas of the nation."* This may, in some instances, contradict article 3.1.6, which says cross-cutting issues like social inclusion and GESI will remain an integral part. In practice, development assistance in these areas were seen as disturbing religious, ethnic and social harmony.

Section 3.2 discusses aid mobilization modalities to be utilized in the three spheres of the government like direct budgetary support, sector-wide approach, and program-based approach. The policy also discusses concessional loans

8 US Department of State. (2021). 2021 Investment Climate Statements: Nepal. US Department of State. https://www.state.gov/reports/2021-investment-climate-statements/nepal/

9 Shrestha, P. M. (2019, November 7). Why has Nepal failed to attract enough foreign direct investment? The Kathmandu Post. https://kathmandupost.com/money/2019/11/07/why-has-nepal-failed-to-attract-enough-foreign-direct-investment

(particularly through EPCF models), other loan assistance (eg, through EXIM Banks), and commercial loans. These are usually preferred for infrastructure development, the latter in areas where there is commercial viability and a high financial rate of return.

However, in practice, concessional and other loan assistance in Nepal have been highly controversial, facilitating corruption and being used by Chinese state enterprises. Their alignment with national priorities remains questionable and there is a need to further study how concessional and other loan assistance have been used in Nepal. Regarding aid modalities, while the government has sought to discourage traditional forms of fragmented western aid by aligning them with national priorities, the government has also encouraged newer models that have led to excessive corruption, like EPCF models.

Article 3.11 discusses cooperation to be implemented directly by development partners and handing over of project on a turn-key basis. These are preferred for *"medium and large-scale projects of high priority, such as construction of hydropower generation, transmission lines, highways, bridges, railways, tunnels, airports, large irrigation systems, dry ports, and for the development of special economic zones."*

Section 3.14 discusses South-South and Triangular Cooperation like SAARC and BIMSTEC.

Part IV of the policy discusses international development cooperation mobilization in the federal structure, which outlines the relationship between the FG and the Provincial Governments (PGs) and Local Governments (LGs). In all cases, the Ministry of Finance will conclude and send financing agreements to the Province or Local governments for implementation. The foreign grants are too be provided as a conditional grant, which may place the PGs/LGs in a state of dependence to the Federal Government (FG). Finance Ministry is also expected to ensure *"representation of the related Provincial government in the activities such as negotiations for development cooperation, project selection, evaluation and feasibility studies of projects to be implemented by the Provincial government."* The provinces, in order to use development cooperation are expected to prepare "an integrated project bank" and forward the proposals to the Ministry of Finance. The same applies to the LGs.

The National Security Policy

The national security policy underscores some common concerns and unstated motives of some key stakeholders but is largely ineffective as a policy guideline. The sensitivity of geo-politics was often understated after the restoration of multi-party democracy in 1990. The National Security Policy 2075 outlined several critical threats linked to geo-politics including blockades, treaties that do not serve national interests, unregulated migration and distribution of citizenship, secessionist activities, and threats generated by geopolitical rivalry.[10]

Informal norms and practices

In addition to the state and inter-governmental agencies, private sector actors including state enterprises and contractors have a major influence on policy decisions. In foreign affairs, normally leaders of political parties have a major say and can bypass or weaken formal institutional mechanisms and processes. In development cooperation and infrastructure development the Ministry of Finance has the biggest influence. Informal norms and practices are driven by the informal culture prevalent in the Finance Ministry, i.e., a culture of fiscal discipline and national interests has remained a powerful factor. However, policy distortions are frequently enabled through a collusion of public, private and political interests. People with direct knowledge say such distortions can affect the work of inter-governmental agencies like the World Bank and ADB. Other specific practices and norms are discussed in the relevant sections below.

C2. Geopolitics and foreign affairs

Political parties conduct their own foreign relations with foreign states as well as political entities. This partisan relationship developed around ideology, identity, and sometimes financial and political support, affects Nepal's national foreign policy as well and has significant impact on governance and domestic policies.

The provinces have been carrying out foreign visits and meetings with foreign emissaries on a regular basis. Such interactions, in addition to their stated governance motives, are influenced by partisan interests as well. As a result, some of the provinces had more opportunities than others. There was no mechanism to ensure that the provinces, during these interactions, were articulating national foreign policy interests.

10 Government of Nepal, (2075). National Security Policy 2075.

Party politics and its relation to FG/PGs

Nepal's foreign policy is primarily shaped by the federal government and topmost leaders of political parties. There was a sense in some provinces (eg, Madhes Pradesh) that the FG was unnecessarily controlling foreign relations (including visits) and had created red-tape in their use of foreign grants and assistance. There was a feeling that the FG had been unable to articulate the interests of the PGs in foreign relations and that there was little dialogue around issues related to development cooperation, investments, and infrastructure projects.

Party politics is affecting relationship between FG and PGs, especially in matters related to infrastructure development, connectivity and foreign policy. During PM K P Oli's tenure, only Madhes Pradesh had a ruling coalition that did not include the Nepali Congress Party (NCP). As a result, other provinces were not forthcoming in protecting the interests of PGs because of political affiliation and only Madhes Pradesh was leading in its struggle to ensure implementation of constitutional rights given to the provinces. Such relationship also reflected in other areas related to infrastructure development and foreign policy. During the last five years, there were several examples of such cases in the relationship between the FG and Madhesh Pradesh.

China

China has been encouraging Nepal to move away from Indian and western influence in both domestic affairs and international relations—by taking "independent" decisions. China views military assistance as one area through which Nepal's independence from India can be achieved. China has been rewarding Nepal with economic benefits and assistance whenever Nepal has stood ground against India. Such quid pro quo practices are likely to continue in the future and influence Nepal's public policy and pursuit of national interests. Since late 2017, China had been counting on left unity to provide stability to Nepal-China relations and it overtly took initiatives to reunify the political parties that had split after PM K P Oli's failed attempt to dissolve the parliament in December 2020.

C3. Infrastructure development and cross-border connectivity

Infrastructure Gap

At present Nepal is facing a significant investment gap in priority sectors. According to a study by Confederation of Nepalese Industries (CNI), investment in priority infrastructure sectors in the six years between 2011-2017 was about USD 7 billion, whereas the need for 2019-2020 was about USD 30-48 billionb

(IIDS & CNI, 2019). A World Bank study quotes Nepal's annual investment needs at around 10-15 percent of GDP whereas the percentage has hovered at less than 2 percent in the last decade (WBG, 2019). One way of meeting this gap is through foreign investments, for which the governments at the federal and provincial levels need to create an enabling environment.

A big gap exists between existing infrastructure and the requirements. At present, the government feels that the major challenge is not of attracting further resources from outside but developing the capacity to effectively use internal resources. Many government officials feel that Nepal currently has enough domestic resources to invest in projects of infrastructure. This widespread belief has partly helped Nepal to resist obtaining loans or financing on unfair terms.

Current situation of infrastructures in Nepal is not satisfactory. For example, most of the accidents take place on roads as a result of poor quality. The government wants to make sure that all palikas are connected to Province headquarters through good roads. The implementation of this policy requires close coordination between Ministry of Physical Planning and the provincial governments. Infrastructure gap is seen by many at the federal level as a theoretical issue. *"It is not a real challenge if we are able to prioritize areas for investment. In this area development partners can be mobilized,"* said a former senior official.

Funding is also profuse for many agencies making it a challenge for them to be accountable and serious about each of them. For example, the Ministry of Health receives money from about 30 different sources. They have a feeling that money is coming anyway and do not feel the need to prioritize.

In the first two years, Province 1 identified 26 projects to attract internal and foreign investments. The earlier Province Chief Minister Sherdhan Rai claimed the province had been able to attract development partners and private sector investors. The Chief Minister cited the agreement between the Swiss government and GoN signed in Biratnagar for NPR 1 billion in aid for Province 1 as an achievement (Rai, 2020).

Prospects and challenges

Nepal Rastra Bank's economic activities study reports provide an important perspective about the provinces regarding challenges and opportunities. Most of the challenges listed for the provinces economic prospects are linked with

investment and increased connectivity with India and China in terms of flow of investments, goods and people.[11] (See Annex I for details)

At the province-level, there is a very generic and rudimentary understanding about geopolitics and foreign affairs, infrastructure-development and cross-border connectivity, and FDI and development cooperation. People living in the provinces feel that there is lack of overall knowledge about international development partners and initiatives like BIMSTEC, SAARC or MCC. But they feel regional initiatives could be useful.

In Province 1, foreign investors appear to be interested in investments. However, due to the lack of jurisdiction of provinces to deal with foreign investors directly, the prospect of materializing the foreign investments has been halted. Considering this, provincial and local governments have been urging the central government to allow provincial governments to deal with foreign investors independently regarding investments for commercial and business motive. Yet, a list of factors including political instability, instability and confusion in the Investment Policy of Nepal, lack of skilled manpower and open border has been demotivating private investors. Similarly, unnecessary burden of tax on the enterprises and businesses with businesses obliged to pay excessive tax to each level of government has also demotivated investors.

In Sudurpaschim, it was argued that Nepal's central government needs to allow its provincial government to participate and negotiate for foreign investments via tools of 'para-diplomacy' to facilitate provincial level investments. Similarly, provinces should also identify goods and commodities with comparative advantage for cross-border trade; by providing Nepali traders with a 'certificate of origin', with which local products can compete in Indian markets. Provinces should also promote their touristic sites in order to attract tourists from both India and China.

The provincial governments, by design, have little role or authority in inviting and regulating FDI. As of now, all the authority rests with the federal government. The provinces also have little ability to create enabling policy environment for FDI given the fact that they have little control over land and forests. Political leaders and civil society members in provinces feel that the provinces should be given more authority in inviting FDIs, especially in areas of comparative advantage.

11 For details, see Nepal Rastra Bank Province Economic Activities Study Reports.

Infrastructure governance

Ministers and officials in the provinces realize that financial discipline and a practice of allocating budget to productive areas (eg, agriculture, tourism, and industries) is necessary. At present, budget is spread across many areas without a clear vision and plan. There is also a feeling that the fiscal year needs to be revised as most of the activities need to be carried out during the rainy season. Expenditure takes place toward the end of the fiscal year leading to irregularities and corruption.

Although there are clear guidelines and procedures on policy making process in FG and Provinces, many of the policies and programs related to infrastructure development appear to be driven by political and financial interests rather than policy interests. Donors have their own priorities and modalities of operating their projects and FG/PGs/LGs can only do so much to influence or shape these programs. Projects of infrastructure development and trans-border connectivity, on the other hand are more visible and invite greater scrutiny.

There are a multitude of problems in infrastructure governance including problems in implementation and project calendar. Some calendars are difficult to implement given the complicated nature of coordination required among federal government agencies (eg, forest issues) and the frequent transfer of project chiefs. The main roadblock in infrastructure development, projects of connectivity and finance is capacity. Capacity related to infrastructure development and development financing is a critical problem for the provincial governments. The FG also does not have the required capacity.

At the province level, there is little understanding about the concept of a project. Provinces usually develop a list of projects (eg, province 1 has developed a list of 100-150 projects), but very few of them can be offered in the market. The provinces do not have sufficient budget for project concept development and expenditures are usually high. Another problem is that the provinces do not have sufficient know how.

Provinces are prioritizing all sorts of infrastructure projects, because their primary motive is to appease the voters. The provinces do not have a well-planned strategy, nor a development plan based on feasibility studies of projects. At the moment, all policies are ad hoc and are political in nature.

Capacity and procurement

In Nepal, the topic of investment and development finance of infrastructure development, particularly of cross-border connectivity, is an evolving topic. So far, provinces only raise about 10 percent of their revenue and have to depend on the federal government for 90 percent. As donors invest in infrastructure (eg, ADB's road upgrading project), they can't work directly with provinces so there is no financial negotiation with provinces. The federal government agencies want to take all the work upon themselves and allow only some nitty-gritty that needs to be worked out to the PGs and LGs. The main narrative is that the PGs and LGs do not have capacity.

Experts who have worked with the government on infrastructure for a long time believe that even FG do not have the capacity if they don't recruit consultants from the private sector. Usually, the federal government agencies have greater experience in contract management and in procurements, but when it comes to actual technical capacity, they also have to depend on consultants. Therefore, the logic is that PGs and LGs can also use the same technical capacity, so it does not really make difference who implements the infrastructure projects.

From governance point of view, many development partners want to work with the provinces and local governments. At the moment, federal government wants to own the procurement process. However, in order to enhance the capacity of PGs and LGs, they also need to start doing procurements. FG agencies are opposed to this saying there will be issues with coordination and quality assurance. However, the primary motive appears to be procurement and potential kickbacks associated with it.

Limited Rights of provinces

Provinces do not have rights on many policy issues, but they have extensive rights in development sector and in infrastructure development. The main challenge for the provinces, as for the federal government, is preparing annual programs without much homework. As a result, the policies and programs become a tome filled with politically attractive physical infrastructure projects with election in focus. The provinces have low human resources capacity; they are not involved in budget, project development, and monitoring. The Ministers want to play a greater role in infrastructure related activities.

Provinces are unable to exercise the rights given by the constitution. Part of the reason is perceived to be discrimination. For example, Province 2 passed

a legislation to form a police force, but the federal government stopped this through a notice. The province filed a case against the federal government.

Relation between FG and PGs

Provinces also have issues relating to geopolitics. For example, Indian Prime Minister Narendra Modi promised Rs 1 billion for the development of a Janakpur and its surrounding areas[12] during his visit in May 2018, but the process has not moved ahead. Officials and elected representatives in Madhesh province blamed the federal government's attitude and its red-tape for the non-utilization of the promised grant.

There is very little understanding between the PGs and FG in area like trade, connectivity, infrastructure, security, environment and natural resource management at the province level. Provinces can have their own policies and programs to boost trade and manage environment and natural resources. However, in order for the provinces to be more effective in these sectors, then there is need for greater coordination with FG ministries. Trans-border connectivity, big infrastructure and security are areas normally preserved for the FG.

Concurrent list

The constitution has restricted the rights of the provinces to collect revenues and domestic resources flowing into the provinces, however, they have rights to use resources in their areas of comparative advantage and priority needs. Schedule 9[13] was added to the constitution later as an afterthought so as to ensure quality in governance. Senior officials involved in designing the policy arrangements said that federalism will take about 10-15 years to be institutionalized and that the constitutional provisions do not hamper provinces in their areas of comparative advantage.

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12 The Wire. (2018, May 11). PM Modi Announces Rs 100 Crore Package to Develop Janakpur in Nepal. The Wire. https://thewire.in/diplomacy/pm-modi-announces-rs-100-crore-package-to-develop-janakpur-in-nepal

13 Schedule 9 allows concurrent powers to the provinces, which they can use in coordination with the federal government and local governments. These relate to fifteen areas: cooperatives; education, health and newspapers; health; agriculture; services such as electricity, water supply and irrigation; service feee, charge, penalty and royalty from natural resources and tourism fee; forests, wildlife, birds, water uses, environment, ecology and bio-diversity; mines and minerals; disaster management; social security and poverty alleviation; personal events, births, deaths, marriages and statistics; archaeology, ancient monuments and museums; landless squatters management; royalty from natural resources; and motor vehicle permits.

Province capacity

Because of the perception that the provincial governments have weak capacity and governance, most of the resources flowing to the Provinces were provided under the modality of conditional grants. There is a feeling at the federal sphere that provinces have a habit of distributing a lot of projects without proper studies, making them fragmented and difficult to implement. Although a project cycle has many phases, most of the focus is on preparing a list of projects. The Fiscal Responsibility Act (FRA) was drafted to discourage development governance, discouraging projects that do not have detailed project reports from being implemented.

Provinces allocate negligible budget for feasibility studies and do not conduct them in many cases. Many projects need international consultants as consultants at the provinces cannot monitor and implement donor projects. It is perceived that their public expenditure management is also very weak. *"For everything they do, they need to hire consultants from outside,"* said a former senior official overseeing development and planning at the federal level.

The problem of implementation of projects arises because provinces do projects with just pre-feasibility studies. The FRA is bound to fail if such practices continue. Provinces also need to improve governance system and structure. Currently the NPC has about 6000 projects submitted by PGs and LGs. It is no more than an ad-hoc list.

Infrastructure and geopolitics

The case of MCC project highlights the relationship between infrastructure development and geopolitics in Nepal, especially cross-border infrastructure. India has already consented extension of the transmission line under MCC compact until Gorakhpur in India.

Corruption, hidden interests/incentives, geopolitical competition and contested relationship between the FG and the PGs are the major obstacles while pursuing policies that serve national interests. Hydro-power sector is also mired in politics and geo-politics. Initially, India was the only buyer, now China has also become aggressive. There are also issues with water resource management including diversion of water. India and China are at constant loggerheads regarding investment in hydro power projects in Nepal.

Connectivity in the northern border

In the northern areas of Nepal, stakeholders are demanding development. The police is 25 km from the border. Except in Rasuwa, connectivity has a local level scope although it is the government's duty to connect headquarters in all the northern districts. The Department of Roads could better focus on north south connectivity in these districts as it is easier and requires fewer bridges.

China, through new civilian settlements, infrastructure and border law, is focusing on its border with Nepal as a site for state making and geopolitical control (Mulmi, 2022). China's state making process across the border has resulted in infrastructure and state asymmetry along the border. While China's development has helped Nepalese settlements in remote areas experience modernity, it has also exposed the asymmetry in the relations between the state and its people. Nepal, in its border regions, must focus more on inclusion, infrastructure and state capacity.

Nepal has issues with both China and India. These issues are not being handled properly so many issues remain unresolved. In the northern region local residents have stated preferring China due to its constant humanitarian and infrastructure assistance.

Geopolitics, view of Chinese companies

Chinese companies used to be very respected, e.g., during the construction of Prithvi Highway. However, they are losing respect because of their interest in making money and in focusing on claim plans rather than on construction plans.

Cross-border connectivity

Cross border connectivity can be beneficial for Nepal. China wants to connect its south western parts to South Asian infrastructure networks. Bangladesh is also interested. These are positive dimensions. However, in developing infrastructure networks, it may be beneficial for Nepal to diversify foreign participation and ensure non-partisanship.

Regional connectivity

Provinces can benefit from cross-border projects of connectivity. In far western Nepal, for example, the terai postal road connects urban points, but the quality of roads is an issue. Another issue is how do the roads connect major destinations, and how do they serve value chain of products with comparative advantage in Nepal to markets in India and China. From a political economy perspective, Sudurpaschim has the potential to develop access point for trade with India and

potential of economic products. As of now, most to the access point to India are in Province 2. Dhangadhi has the prospect to advance regional cohesion. Entry point to good governance is through infrastructure governance. Entry point to corruption is also through infrastructure.

Norms and practices

Regional projects of cross-border connectivity have become closely tied to geopolitical, financial and ideological interests and are vulnerable to contestations in public. There is also an uneasy relationship between development cooperation conducted by development partners with both government entities and political parties. Interests in procurements and financial kickbacks is also a major factor shaping informal norms and practices. Bureaucrats perceive that development partners sometimes use their clout and power to push through development programs that are not fancied by civil servants.

C4. FDI and development cooperation

China has been the largest source of Foreign Direct Investment (FDI) to Nepal for the last four fiscal years. FDI from China to Nepal in FY 74/75 amounted to Rs. 45,326 million which is significantly a large number because there were two big private investments including Hongshi Cement and Huaxin Cement with the Nepal government.[14] Initially Chinese investments were limited to smaller businesses, but recently their presence can be seen in the hydropower and infrastructure development sector.[15] According to multiple sources, signing of BRI agreement also played an important role in China's increasing investments in Nepal. Similarly, the recent trend of FDI from India shows a declining trend. This decline in the FDI could be attributed to the ongoing Covid-19 pandemic and political uncertainty between India and Nepal.[16] Likewise, FDI from USA has shown a fluctuating trend. The FDI in FY 77/78 decreased significantly due to pandemic.

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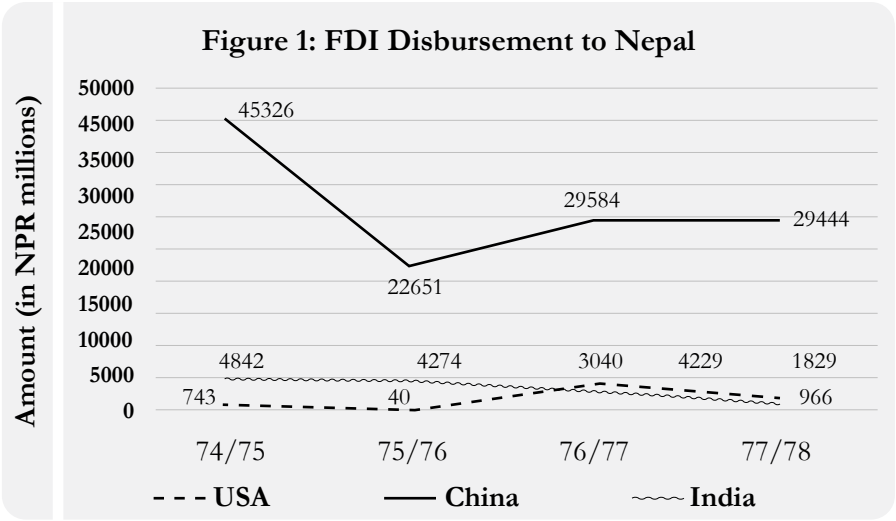
14 Pandey, A. (2020, November 23). Economics and Influence: Chinese Investment in Nepal. Stimson Center. https://www.stimson.org/2020/economics-and-influence-chinese-investment-in-nepal/

15 Xinhua. (2021, July 21). China remains largest source of FDI for Nepal for 6 consecutive years - Xinhua | English.news.cn. Xinhuanet. http://www.xinhuanet.com/english/asiapacific/2021-07/21/c_1310075557.htm#:%7E:text=KATHMANDU%2C%20July%2021%20(Xinhua),released%20by%20Nepal's%20Department%20of

16 Prasain, K. (2021, April 11). Foreign investment pledge falls 12.7 percent as India's commitment slumps. The Kathmandu Post. https://kathmandupost.com/money/2021/04/11/foreign-investment-pledge-falls-12-7-percent-as-india-s-commitment-slumps#:%7E:text=Nepal%20received%20investment%20pledges%20of,13%20billion



Source: Department of Industry

Nepal and China signed a MoU on bilateral cooperation under the framework of the BRI on May 12, 2017. In January 2019, Nepal proposed nine projects to be developed under BRI.

Rasuwagadhi-Kathmandu road
Kimathanka-Hile road
Dipayal-Chinese border road
Tokha-Bidur road
Galchhi-Rasuwagadhi-Kerung 400kv transmission line
Kerung-Kathmandu rail
762MW Tamor hydroelectricity project
426MW Phukot Karnali hydroelectric project
Madan Bhandari Technical Institute

Land acquisition as a bottleneck

The biggest bottleneck in infrastructure development is land acquisition, which is becoming a big monster. Land acquisition is also a key issue in building and upgrading roads, as the upgraded roads need new gradations, alignments and right of way. Land acquisition has also become prohibitive for other infrastructure projects like hydropower and transmission lines.

The government needs to provide services and facilities to the investors. However, a key obstacle is the availability of land and its management. Province governments do not have a right to allocate land. Another issue is of land

management. Still guthis own lots of lands in many parts of Nepal and the use of these lands for productive purposes has become controversial.

Basin-wide perspective

Another issue with government policies is the inability to look at projects as part of a broader basin-wide perspective. This is especially relevant for Karnali, Budhigandaki and Arun basins. The government could plan roads, airports and other facilities as part of a broader development goal in the river valleys. As a result of the hydropower projects, there could be spin off commercial activities related to tourism and adventure sports.

Viability Gap Funding

Many projects may not have adequate commercial returns but may be beneficial to the country from other strategic or economic development perspectives. In such cases the government needs to agree on a viability gap funding. For example, in the case of Terai Fast Track project, a combination of improper policies and geopolitical factors led to the project getting out of control. Initially, when Indian companies showed interest in the fast track, the total cost of the project was about USD 900 million to 1 billion, with the viability gap expected to be around USD 200 million. However, subsequent decision of the government to give the project to the Nepal Army has meant that the total project cost has now escalated to at least USD 2.6 billion.

Private sector actors

In the case of infrastructure development or procurements, private sector actors reach out to elected representatives (e.g., a mayor) directly to promote a certain project or procurement. The relationship between PG and FG, to a great extent is also determined by interests around procurement. FG officials argue that the PG does not have the capacity to handle projects and procurements, but according to knowledgeable informants, the primary motive behind these statements is an interest in procurements and kick-backs.

Local businesspersons feel that the government should first promote domestic investments for which a supportive environment needs to be created. Proper planning and investment is needed in the agriculture sector to substitute imports, especially through infrastructure projects like irrigation.

Political and social buy-in

Usually, for an infrastructure development project, the gestation period from conception to implementation is very long. It is not enough to just do an

MoU with an investor. The government needs to complete many steps before giving a project to an investor and there are lots of risks as well as stakeholders involved. Political and social buy-in is also necessary for a project if it is to move smoothly. The case of MCC Compact serves to highlight the importance of buy-in and communications with all related stakeholders from early on. If there is ownership of a project by the stakeholders and the local communities, the project can move ahead smoothly.

The availability of development finance or money is not perceived to be a major issue. The main challenge is seen as the ability of the government to ensure a seamless process of investment and quality partnership with the investors.

External actors like investors or donors are perceived to be necessary to complement domestic investments but the government does not feel sufficiently pressured to enact reforms in the sector to facilitate such investments.

Alignment between FG and PGs regarding FDIs

There is no alignment between the Federal Government and the Provincial Governments regarding FDIs. Some provinces have established Investment Authority (e.g., Province 1), while others have so far given little emphasis. The federal government has kept all rights related to FDI to itself. Experts, however, feel that there is little coordination and connection between ministries/agencies and their respective roles.

Anything to do with FDI, FG has kept it to itself. Even service requires permission or approval. There is no process regarding which agencies are to do what. There is no inter-ministerial connection and coordination. There is no coordination among MoFAGA and Finance. As provinces seek to form their own investment authorities, there should be clear legal mechanisms for coordination and alignment with the federal level.

The constitution has given the power to the federal government regarding FDIs. Therefore, provinces can only collaborate with the federal government in order to invite FDIs. Minister of Planning of Madhesh Province says, *"We invited FDIs in Madhesh Pradesh and the province government wanted to support such investment, but we could not manage land for the projects. Guthi has authorities over the land, and the guthi is controlled by the federal government. Even the 'mahanta' does not support in these causes."*

In collaboration with Chaudhary group there was a plan to establish a project for producing 200 MW electricity through solar, but due to the provision that you cannot invest directly in the provinces that project was cancelled and similarly the Maruti tile industry project was cancelled.

PPPs

PPP policies at the provincial and local levels is a relatively new phenomenon. Implementation of the PPP policies has largely given rise to Mayors or Chief Ministers invoking their authority. Development partners are also introducing PPP programs, which may need about 4-5 years to take shape. Foreign and domestic private companies approach Mayors and Chief Minister's directly on projects related to PPP. In many instances, this has given rise to cronyism rather than an equal and open opportunity for all of private sector.

ADB, the World Bank and FCDO are interested in PPP. Many donors are interested in soft areas and all are now focused on capacity building. The PPP Act, which has been formulated, is facing challenges. *"When it is time to give projects, only cronies get a chance,"* says a senior government official.

DFIs modality

Development Finance Institutions should also seek to revise their working modalities. One concern is the duplication of efforts in their work. Second is the involvement of local Nepali citizens in leadership and other roles which could add social accountability and ownership of the projects.

Development Cooperation

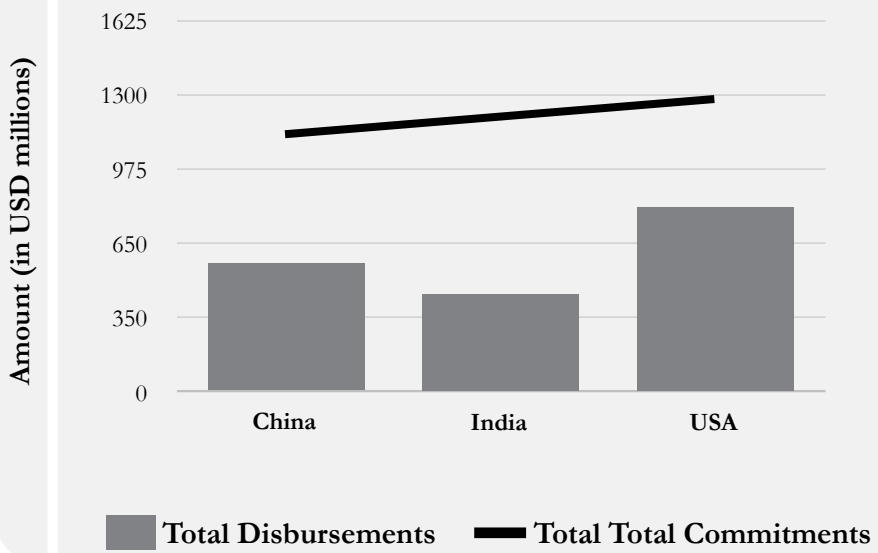
Foreign assistance frameworks are largely transparent, except for aid modalities for small grants in southern and northern districts operated by India and China. In order to avoid conflict between India and China, the federal government has allocated the northern 15 districts to China to operate their small grants program whereas India normally operates in the southern districts. How China and India spend money (around Rs 15 billion each) under these modalities is not clear.

Since January 2015, India, China and the United States have so far disbursed over USD 1.7 billion worth of grants and loans, averaging about USD 253 million per year. During the same period, they have made commitments of about USD 3.6 billion. This includes the USD 500 million grant commitment for a MCC compact. Among the three, the USA is the biggest donor with about USD 808 million in disbursements. China has given about USD 538 million, some of it as loans, while India has disbursed about USD 422 million[17].

17 https://amis.mof.gov.np/

Development partners and funding agencies are keen to work with PGs and LGs. However, federal government agencies do not encourage such direct communication. Provincial Governments at the moment have weak capacity and cannot state their needs. However, they are used to periodic planning and developing masterplans. FGs do not show keenness in working with UPs, however since they are the channel, they want some control.

Figure 2: Development Finance: India, China and The US (2015-2022)



PPPs have not been implemented in a proper sense, many do not reflect proper procedures, accountability, and transparency in governance.

In Madhes Province, lack of clarity between the roles and jurisdiction of the provincial and federal government is hindering development cooperation with foreign countries and investors. There is a huge discrepancy between the understanding of centre (Kathmandu) and the ground reality – problems of Madhes province. Due to this discrepancy, there is a lack of investments flowing in the province for development projects. Moreover, many students from Madhes Province migrate to India to get their education; signaling there is an opportunity to invest in educational sector and provide quality education to the students. Likewise, trade imbalance (between import and export) in the province can also be addressed by increasing production (agricultural) industries in Madhes.

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Norms and practices

The Provincial Governments want to have greater access to development partners (DP), especially in areas related to infrastructure, capacity development (CD) and delivery of services. The PGs do not just want CD, they want CD to be combined with more "concrete" assistance that can be visible to their constituents. The PGs also want to work with DPs in areas related to environment and climate change, issues that could have global significance. The Federal Government has limited the access of the DPs to the provinces. So far, the DP's have been allowed to work with LGs, but they have no direct access to PGs. One exception is Province 1, where the Swiss have signed a tripartite agreement and are working in the province. Their support is included in the official annual program of the province.

The Swiss government has signed a pact with Province 1 and is operating its development cooperation programs in coordination with the province. Other development partners have little direct contact with provinces. Private sector and state enterprises, on the other hand have been approaching mayors of big municipalities with ideas about projects that they can then engage in.

D. ANALYSIS AND CONCLUSIONS

Geopolitical competition is likely to have greater impact in the future in Nepal's politics and governance. In particular, the USA, India, and China seek to have greater influence on the governments and expect a high degree of loyalty. Such competition reflects on these state's relationship with Nepali political parties as well. As stated clearly by Xin Jinping and Wangi Yi, China wants to see a stable

government and governance system that remains steadfast to China's strategic and security concerns. Such concerns may invite greater measures and counter-measures in the future.

Geopolitical conflict is a major challenge while the governments pursue policies for infrastructure development and regional connectivity. Another major area of conflict is sharing of potential kick-backs through corruption and impunity while developing these projects. The third area of potential conflict relates to acquisition of land and relationship with local communities and stakeholders who may have multiple motives.

Nepal's relationship with India

In addition to state-to-state relationship, there are locally relevant economic dynamics in the provinces. Regional and local supply chains and economic relations that cut across political boundaries are quite diverse and there are many areas where the provinces can enjoy comparative advantages. Some chains are mainstream and well known. For example, supply chains related to herbs are extensive in Sudurpaschim. Other supply chains are not so well known. For example, in Province 1, there was a supply chains related to waste products which was of relatively high value. These areas need to be further studied to gather greater insights.

Nepal's relationship with China

Geopolitics will influence Nepal's efforts to develop infrastructure and projects of connectivity. For example, China wants to have a share in electricity grid in South Asia and sees projects under MCC as a threat to its interests regarding smooth access. China feels that the US maybe trying to isolate China from access to Nepal's infrastructure network. Similarly, India sees Chinese investments in Nepal in the infrastructure sector, especially under BRI, as a threat to India's national security interests.

Relations with China regarding development of cross-border connectivity projects is seen as being more difficult, including from engineering point of view. The railway will not be feasible if it does not link India. According to senior government officials, cross border infrastructure with China will becomes more feasible if India consents to the projects of connectivity. The political dynamics between India and China will have a clear impact on projects of cross-border connectivity with China. At the moment, according to senior officials, India shows concerns even when some of the contractors in Nepal are Chinese.

China's economic and political influence has grown so quickly that countries with less than robust state and civil society institutions "have struggled to grapple with the implications." According to Carnegie studies, vulnerability arises from the gap between *"the scope and intensity of Chinese activism…and…local capacity to manage and mitigate political and economic risks."* [18] According to Aid Data, *"A typical loan from China has a 4.2% interest rate and a repayment period of less than 10 years. By comparison, a typical loan from an OECD-DAC lender like Germany, France or Japan carries a 1.1% interest rate and a repayment period of 28 years."*[19]

Chinese experts perceive that Nepal has become a key pivot in American strategy towards China and that through MCC, Nepal has become an important part of Washington and New Delhi's anti-China coalition.[20] In the face of increased competition from the USA, India and EU in the infrastructure market, China will be aggressive, especially in its security interests, but will hope evolution of relationship with India will ease matters. Security of Tibet and One-China policy will continue to remain non-negotiable for Chinese diplomacy in Nepal.

China will face increased competition from Build Back Better World Initiative (G7) and Global Gateway Initiative (EU) in the global infrastructure finance market. China believes that the USA wants to build a US-dominated infrastructure network in Nepal by excluding participation of other countries like China. According to Chinese experts this would cause "a split" in regional cooperation. Therefore, evolution of India-China relationship will, to a great extent, determine the spill-over effects of geopolitical competition in Nepal.

During his visit to Nepal, Chinese State Councilor and Foreign Minister Wang Yi in 2022 framed the ratification of MCC as a geopolitical intervention in Nepal and said that China would oppose such interventions.[21]

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18 Brattberg, E., & Feigenbaum, E. A. (2021, October 13). China's Influence in South Asia: Vulnerabilities and Resilience in Four Countries. Carnegie Endowment for International Peace. https://carnegieendowment.org/2021/10/13/china-s-influence-in-south-asia-vulnerabilities-and-resilience-in-four-countries-pub-85552

19 Wooley, A. (2022, February 7). AidData's new dataset of 13,427 Chinese development projects worth $843 billion reveals major increase in 'hidden debt' and Belt and Road Initiative implementation problems. AIDDATA.

20 Global Times. (2022, February 28). GT Voice: The US' MCC pact with Nepal threatens peace, development in South Asia. https://www.globaltimes.cn/page/202202/1253492.shtml

21 Xinhua-Global Times. (2022, March 27). China opposes any attempt to undermine Nepal's sovereignty and engage in geopolitical games in the country: FM Wang Yi. Global Times. https://www.globaltimes.cn/page/202203/1256876.shtml

Questions about the relevance of Provinces

Investment and infrastructure development modalities have given rise to question of whether Provinces are really necessary. For example, Province 1 wants to revitalize the Udayapur cement factory, which still has significant amount of limestone. This requires synergy between federal strategy, province strategy and local strategy as well as buy-in from all levels. It requires alignment in priorities and strategies, as well as changes in the investment laws. Many experts view that investment opportunities should be given to the PGs with a coordination mechanism, but without provisioning restrictions in FDI.

Challenges related to para-diplomacy is another emerging dimension. Review of literature regarding para-diplomacy and Nepal's own experience show that there are several challenges regarding para-diplomacy and geopolitics:

(a) coherence between national foreign policy and pursuit of sub-national interests;
(b) the pursuit of strategic interests by external actors at the subnational level, especially by courting sub-national actors,
(c) how to generate public policies and practices at the subnational level that align with national foreign policy interests and address the issue of security dilemma posed by conflict of geopolitical interests,
(d) the tendency of governments or government agencies in Nepal (both at the federal and sub-national levels) to be influenced by partisan, financial or foreign interests that can undermine national interests or cause security dilemma; and
(e) the conflict of interests between the federal government and a province, or the possibility that the federal government may not articulate the interests of the substate units.

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ANNEX I

Economic Challenges and Prospects of Selected Provinces

PROVINCE 1	PROVINCE 2	PROVINCE 7
Challenges		
Allocation of adequate amount in annual budget for sectoral priorities	Clean environment	Promoting self-dependence through all round development
Use of reliable data and statistics in planning	Education hubs	Poverty and lack of investments
Distribution and mobilization of resources through greater coordination among the FG, PGs and LGs	Fishery	Infrastructure development and financial literacy
Import substitution	Promote contribution of industries to GDP	Poor revenue collection ability
Taking benefit of Chinese and Indian markets (by promoting goods with comparative advantage)	Develop as a tourist hub	Attracting domestic and foreign investments
Benefitting from trade and tourism with India and China	Availability of fertilizers and attracting youth for agriculture development	Implementation of budget and programs through better relations between FG, PGs and LGs
Financial inclusion	Hub of connectivity and economic activities	Addressing impact of Covid 19
Attracting domestic and foreign investments		Need to go to India for employment
Prospects		
Commercialization of agriculture and import substitution	Economic activities in the plains	Agricultural products and commercialization of agriculture

Tourists from India and China	Agriculture and industrial development (entrepôt for trade)	Vegetables and fruits
Domestic and foreign investments in water resources	Borders India, so export potential	Cash crops and economic activities
Access to Indian and Chinese markets	Tourism and entertainment	Generating employment through industrialization
Contribution of industries to GDP		Expanding finances through loans

Source: Nepal Rastra Bank Province Economic Activities Study Reports.

Chapter 3

Cross Border Relations and China's Engagement with Nepal Along Nepal's Northern Border

Shraddha Ghimire[1]

A. BACKGROUND AND CONTEXT

A1. Cross border relations and engagements – historical perspective

Cross-border relations between Nepal and China can be traced back to as early as the Tang dynasty (from 644 to 650) and Ming dynasty (1384 to 1427), up until Nepal's Malla dynasty when it briefly terminated for a short period of time (Gokhale, 2021). Post this period, the Kathmandu Court established bilateral relations with Tibet (in particular with the government and officials of Dalai Lama). During the 17th century, the political instability in Tibet provided an opportunity for the then King of Kathmandu, Partap Malla to acquire trade monopoly in Tibet (Mishra, 2003).

Between the 16th and 17th century, the internal conflicts within the Phagmodrupa dynasty (Yü & Wangmo, 2018) and other competing Buddhist sects, regional conflicts between two Tibetan provinces of Lhasa and Xigatse along other foreign invasion tensions (such as potential invasion from Mongols or Gorkhas[2]) had weakened the Tibetan state. Taking advantage of the situation, King Malla attacked Tibet from the period between 1645 and 1650 and forced Tibet to sign a peace and trade treaty favorable to the Kathmandu court (Mishra, 2003). The agreement was signed by his brother Bhim Malla on his behalf (Baral, 1972). As per the agreement, Nepali merchants and traders were permitted to open 32 trading houses in Lhasa; the king could appoint his representative at the Court of Lhasa and Tibet promised not to levy taxes on trade done by Nepali merchant throughout Tibet. Similarly, Tibet agreed to conduct all trade with India, via Nepal. The treaty also allowed Nepali men to marry Tibetan women, alongside

1 With contributions from Arpan Gelal

2 Walt, M. C. V. (1987). LEARN A LITTLE ABOUT TIBET. Students for a Free Tibet.

ensuring Nepalese citizenship to male-child born from the marriage (Mishra, 2003). This facilitated the exchange of culture, tradition, religion and language across the two nations. Gradually, succeeding treaties signed in the years 1789, 1792 and 1856 between Nepal and Tibet further deepened Nepal's relationship with her northern neighbour, paving path towards a solid bilateral relation[3].

A2. Cross border relations and engagements – contemporary perspective

Fast forward to present, Nepal's bilateral engagements with her northern neighbour has expanded beyond conventional cross-border engagements including a revived interest in physical infrastructure, foreign direct investment, road and railways connectivity and development of Nepal's northern districts. Trade and transit facilitation has also been viewed as a win-win situation for both countries. Similarly, China has great influence over Nepal's security forces and intelligence with Chinese security officers often playing a role in monitoring and suppressing Tibetan activities within Nepal. Moreover, China has also made generous investment on security training and capacity building of Nepal's security forces; thereby directly intervening with Nepal's national interest through bilateral engagements (Mukhopadhyay, 2020; Rana, 2020; Jha, 2013; Shneiderman, 2013).

A3. Chinese interest and investment along northern border

While Chinese influence and interest along Nepal's northern borders began to notably increase post 2008 (when Nepal transitioned into a federal democratic republic from a monarchy), it was after the 2015 earthquake followed by border blockade along Nepal's southern border points which presented China with an opportune moment to expand its overall economic engagements with Nepal on both macro (national level) and micro (local level). China rapidly began to increase its participation in Nepal through foreign direct investment, trade and transit facilitation, projects under the belt and road initiative and various infrastructural development. Similarly, China also began to exert its influence over Nepal's northern borderlands primarily through disaster and humanitarian relief, construction of roadways (connecting northern districts to the capital city of Kathmandu) and the construction of hydro power projects, and integrated border facilities.

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3 This section is based on the following literature-
University of Arkansas. (n.d.). University of Central Arkansas | UCA. https://uca.edu/political-science/dadm-project/asiapacific-region/chinatibet-1950-present/
Rana, P. S. J. B. (2020, November 3). Considering the Nepal-China border - The Record. The Record. https://www.recordnepal.com/considering-the-nepal-china-border
MoFA. (n.d.). Nepal-China Relations – Ministry of Foreign Affairs Nepal MOFA. Ministry of Foreign Affairs. https://mofa.gov.np/nepal-china-relations/

China has also been aggressively expanding its local engagements (in northern borderlands) with Nepal via the China International Development Cooperation Agency (CIDCA) since 2018. CIDCA primarily aims to create model cities in 13 of the 15 northern districts of Nepal to facilitate China's cross border engagements with Nepal. Similarly, China has also announced to intensify the implementation of projects under the Belt and Road Initiative (BRI), under the umbrella 'Trans-Himalayan Multidimensional Connectivity Network (THMCN)' in a bid to increase its connectivity across Eurasia using Nepal as a transit hub[4] (Rana, 2020; Yadav, 2021).

A4. Border security dilemma along northern border

Border security dilemma along the Nepal-China border line primarily revolves around the smuggling of illegal items such as animal products, gold and red sandalwood alongside issues of local human trafficking and labour abuse. While on a more national level, the security threat of unlawful border entry and exit (Tibetan migration) has been a matter of great concern. Considering this, Nepal has signed a number of security agreements with China throughout the years including – the 2011 Comprehensive Security Pact (CSP) covering border security, inter-agency collaboration, smuggling, trafficking, and other illegal border crossings. The same agreement has also stipulated a mechanism for intelligence-sharing on anti-Chinese activities with effective law enforcement mechanisms to control such activities alongside developing a protocol of cooperation between Chinese and Nepali security agencies and border forces.

Similarly, during Premier Wen Jiabao's visit to Nepal in 2012, Beijing pledged financial and technical assistance worth USD 1.6 million (Yuan 10 million) to enhance the capacity building and training of the Nepali Police Force (NPF) alongside singing another pact for the development of a new Nepali Armed Police Force (APF) academy in Nepal to increase border security and management. Likewise, in 2012, a District-Level Mechanism was signed at Lhasa to accelerate Beijing's desire to curb any pro-Tibetan movements along Nepal's northern border districts alongside establishing an effective security strategy to solve cross-border issues and probable security dilemmas[5].

4 Giri, A. (2021, January 5). China's foreign aid agency is all set to make foray into Nepal's northern region. The Kathmandu Post. https://kathmandupost.com/national/2021/01/05/china-s-foreign-aid-agency-is-all-set-to-make-foray-into-nepal-s-northern-region

5 Mulmi, A. R. (2019, October 15). When China and Nepal became 'strategic partners' | Analysis. Hindustan Times. https://www.hindustantimes.com/analysis/when-china-and-nepal-became-strategic-partners-analysis/story-HXfhyfBAsX4OIvygbJrQYK.html

A5. Third country engagement along northern border

With regards to third country engagement along the Nepal-China border, China vehemently opposes the engagement of Indian and Western countries and their security forces in the northern border districts of Nepal particularly due its sensitivity regarding the Tibet Autonomous Region (TAR)[6]. Up until the late 1990s, the United Nations High Commissioner for Refugees (UNHCR) had access to northern border districts of Nepal wherein they monitored local situations and instructed local border security forces (of Nepal) regarding the mechanics of the Gentleman's Agreement.

The 'Gentlemen's Agreement', was established between Nepal and the UNHCR (United Nations High Commissioner for Refugees) to provide safe and discreet transit of new Tibetan arrivals through its territory. The agreement states that Tibetan refugees apprehended by the Nepali authorities be handed over to UNHCR for processing and transit to Dharamsala.

However, in 1998, the Government of Nepal (GoN), discontinued UNHCR's access to its northern borderlands fearing the 'Tibet issue' to be misapprehended by the Western world as an irritant factor in its bilateral relations and border management mechanisms with China. Thus, post 1998, both the governments of Nepal and China have prohibited any western forces and powers to conduct formal or informal activities along the Nepal-China border line[7].

A6. Provincial and local governments' strategies for border security

Border security has been categorised as the basic element in the national interest of Nepal under article 5 of the Constitution of Nepal (2015). In-line with the provision of National Security under part 28 of the constitution, article 268 stipulates for the formation of provincial police forces in each province of Nepal for border management and security. The article stipulates for the operation, supervision and coordination of functions to be discharged by the Nepal Police and the State Police (along borderlands) as mentioned in the federal law. Similarly, the 'First Amendment Ordinance' as issued by the President Bidhya Devi Bhandari on September 2020 also mandates Nepal Police to investigate offense including those against the state, immigration offense, organised crime, terrorism, human trafficking, cybercrime and other

6 Human Rights Watch. (2015, June 16). Under China's Shadow. https://www.hrw.org/report/2014/04/01/under-chinas-shadow/mistreatment-tibetans-nepal

7 Ibid.

cross-border crime. However, the delay on part of the government to come up with the 'Federal Police Act' has created a legal vacuum in the federal set-up; hindering the surveillance of cross-border security and management by the local and provincial governments[8].

B. DESCRIPTION OF RESEARCH REPORT

B1. Description

This research study focuses on the cross-border relations and engagements between Nepal and China and China's increasing engagements and interest in Nepal in the northern border districts. There are four main research questions that have guided this study. Amongst them, the first one seeks to understand how the current border security and management protocols along the northern borderland has been affecting the general livelihood of local border inhabitants with special focus on poor, women and marginalized people. The second question highlights China's strategic interest and engagements along this region, in particular, its perusal of public diplomacy, investments, aid and development assistance. Similarly, the third question focuses on analyzing probable border problems, issues and recent border disputes along the Nepal-China border. The last question explores the possibility and feasibility of future regional connectivity (roadways and railways) between Tibet Autonomous Region (TAR) of China and Nepal with the Trans-Himalayan Multidimensional Connectivity Network in hindsight.

B2. Definitions

Outlined below is the definition of key terms and words in accordance to how they are used in the research study.

a. Border security and management – the measures taken by the government of Nepal (GoN) to monitor and regulate the movement of people, animals and goods along the 1,415 kilometers (kms) long international boundary with the Tibet Autonomous Region (TAR) of China under constant regulation by the Sashastra Prahari Bal (Armed Police Force) on Nepal's side and the People's Armed Police (PAP) on the Chinese side of the border.

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8 This section is based on the following literatures-
Constitution of Nepal, 2015
Khatri, P. (2020, September 29). Govt paves way for police integration. GorakhaPatra. https://old.risingnepaldaily.com/main-news/govt-paves-way-for-police-integration
Himalayan New Service. (2020, February 13). New act stipulates jurisdiction of federal, provincial police. The Himalayan Times. https://thehimalayantimes.com/kathmandu/new-act-stipulates-jurisdiction-of-federal-provincial-police

b. Cross border relations and engagements – the interaction and exchanges across Nepal-China border including local engagements (local flow of language, religion, culture, ideas and goods) and national engagement (official and diplomatic engagements between Nepal and China as formalized since 1955).

c. Strategic interest and concern – the political, diplomatic, security, military, economic and cultural influence and importance for Nepal and China along their border which has direct fundamental strategic concerns to each other's national interest.

d. National interest – safeguarding of the freedom, sovereignty, territorial integrity, nationality, independence and dignity of Nepal and China and the rights of their citizens and their economic wellbeing and prosperity along the Nepal-China border.

e. Northern border districts – Darchula, Bajhang, Humla, Mugu, Dolpa, Mustang, Manang, Gorkha, Dhading, Rasuwa, Sindhupalchok, Dolkaha, Solukhumbu, Sankhuwasabha and Taplejung are the fifteen northern districts of Nepal.

f. Northern borderland – territories (communities, villages and towns) at or near Nepal-China border.

g. Security dilemma – situations wherein actions are undertaken by either the government of Nepal and China to increase its security in response to reactions from either of them along their shared border line.

h. Unconventional security threats – environmental degradation, pandemic, ethnic, racial or religious conflicts, inequality and poverty, human trafficking, corruption, migration and trans-boundary crime along the Nepal-China border.

i. Transhumance – practice of moving livestock from one grazing land to another in a particular season (in this case across the Nepal-China border).

j. Trans-Himalayan connectivity – an economic corridor between Nepal and China as a part of China's Belt and Road Initiative to develop connectivity across Eurasia.

k. Public diplomacy – local people's diplomacy or national efforts aimed at communicating directly with foreign publics.

l. Local security dynamics – the process used by local people to define security and their security needs.

m. Surveillance needs – careful watch or observation of new, unusual or peculiar activities along the Nepal-China border.

B3. Key research questions

The study addresses the following research questions-

a. How are China and Nepal managing border security? How can border security be improved without hampering the livelihoods of poor and marginalized people?

b. How is China pursuing its interests in the northern border districts? What is China's strategy behind its engagements (for instance- public diplomacy, investments, exchanges, development assistance, participation of Chinese companies)?

c. What kinds of disputes or problems have emerged in Nepal's border relations with China?

d. Given China's strategic needs and interests, what kind of connectivity (flow of good, people, and idea as well as cooperation) is feasible in the future?

B4. Rationale and Significance

a. China's engagements in Nepal's northern border districts are shaped by China's national security concerns. Any future trans-border connectivity project needs to align with China's security interests in order to be feasible.

b. Nepal's friendship with China prioritizes border security over flow of goods, people, and ideas. Nepal has largely been unable to take advantage of its connectivity with China because of China's concerns about its national security.

c. Tight control of cross border flows is likely to have most impact on the poor and vulnerable groups. There is a need to understand the impact of re-bordering and to devise ways to manage the border and border security without hampering the interests and livelihoods of women, the poor and vulnerable population.

d. Nepal government usually tries to downplay problematic issues or disputes with China. If there is any dispute or issue linked to Nepal's national interest, or the interests of people living along the northern border, it needs to be resolved quickly and amicably rather than being swept under the rug.

e. China's security and surveillance needs vis-a-vis Tibet may be generating multiple local dynamics that can have an impact on the livelihoods, rights and freedom of local people, including the traditional privileges protected by the 1956 Treaty on Economic Aid.

B5. Approach and Methodology

To probe into the above-mentioned objectives and questions, the research employed the following research approach and methods:

a. Desk Research/Review of Literature

To initiate the research, a preliminary desk research and review of literature was carried out to track down all useful and existing pre-published information from primary and secondary sources including treaties and bilateral agreements, cross-border movements and mobility reports, cross-border engagement reports, joint statement from high-officials' visits, scholarly articles, journals and media reports, interviews of officials published in media, and websites of both public and private bodies that work closely in facilitating cross-border engagement.

b. Qualitative Survey

The process of qualitative survey was carried out through field visits to five key northern borders and two strategic cross border points, household surveys and key informant interviews (KIIs).

b1. Field Visit – It was focused on gathering information from local perspective about the cross-border engagements that complemented the literature review and helped identify patterns in cross-border engagements to contextualize border developments. The five key northern borders included Dolakha, Humla, Rasuwa, Sindhupalchok and Taplejung. Similarly, the two strategic cross border points included Tatopani-Khasa (Sindhupalchowk District-Nyalam County), Rasuwagadhi-Kerung (Rasuwa District-Gyirong County), where representatives from Nepal Police, Armed Police Force, Nepal Army, Civic Society, Provincial Leaders, Ward Chairperson and Government Officials and local border residents were interviewed. Upon completion of field visit, the second phase of KII was conducted with experts and stakeholders in Kathmandu to gain their insights on the research questions.

b2. Household Surveys – Complementary to the field visit, household surveys were also conducted in each key northern districts and strategic cross border points to understand the perspective on cross-border engagements on a more local level.

c. Data Analysis

The researchers then collated and analyzed all information received from the qualitative surveys (desk research, literature review, field visit, household surveys and KIIs) to write the report. The data analysis considered all factors such as economic and social transaction (at the local level) followed by state-level transaction and engagements between Nepal and China. Moreover, interactive discourses and dialogues with relevant stakeholders also formed a part of the analysis to extrapolate the report.

C. KEY FINDINGS

C1. Nature and status of Nepal-China border

C1.1 Border agreements and protocols

Over the last few years, some of the major agreements, understandings and military assistance signed between Nepal and China to operationalize border security and management include – China pledging a military assistance of USD 989,000 to Nepal in 2005 (Jaiswal, 2014) to curb the Maoist insurgents in Nepal; military aid of USD 3.28 million for the supply of 'non-lethal' military hardware including logistics and training regarding border security to the Nepal Army (Jaiswal, 2014). Later in 2008, China provided USD 525,000 under the condition that Nepal restricts any anti-China activities on its territories (Jaiswal, 2014). Similarly, a six-member delegation led by the Chinese Director of the Tibet Autonomous Region's (TAR) Public Security Department (PSD) visited Nepal in December 2010, offering to assist Nepal's security forces stationed along the Nepal-China border, emphasizing 'the need to control illegal immigrants from both sides'[9]. The same delegation offered to provide half a million yuan (USD 80,000) to Nepali security agencies for logistic support. Similarly, in early 2011, the Ministry of Public Security (MoPS) in Beijing hosted a 'high-level training' for Nepali security professionals. The training centred on 'hitting illicit border exit-entry actions'[10].

9 Human Rights Watch. (2015b, June 16). Under China's Shadow. https://www.hrw.org/report/2014/04/01/under-chinas-shadow/mistreatment-tibetans-nepal

10 Ibid.

Likewise, in August 2011, China agreed to provide USD 7.7 million in financial military aid to deepen the defence and security ties between the two nations in terms of border security (Sharma, 2021). In the same year, a comprehensive security pact including border security, inter-agency collaboration, smuggling, trafficking, and illegal border crossing was also signed between the two countries which established a mechanism for intelligence-sharing and cooperation between Chinese and Nepali security agencies and border forces[11]. Fast forward, in July 2012, China and Nepal agreed to *'develop mechanisms to ensure exchange of information on a real-time basis and establish effective cooperation between the security agencies of the two countries to control illegal activities in border areas'*[12]. Within the same, China demanded Nepal to submit 'a proposal for financial and infrastructure aid required to enforce an effective security strategy along the Nepal-China border to check cross-border crime'. Chinese at that time had raised the issues of illegal drug trafficking and human trafficking across the Nepal-China border, terming it as the second biggest concern on its cross-border engagement with Nepal after pro-Tibetan sentiments (Jaiswal, 2014).

C1.2 Border management and security

Nepal and China coordinate their border security and management along the Sino-Nepal border points. On the Nepali side, representatives from Nepali Armed Police Force (APF), Nepali Police (NP), Nepal Army (NA) and personnel from Customs Office (CO) are primarily assigned with managing the Nepal-China border. At present, there are Border Out Posts (BOP), Immigration Offices (IO) and Customs Offices (CO) at two border points of Rasuwagadhi-Kerung and Tatopani-Khasa. Also, in border points of Burang-Yari and Lizi-Nechung, both Border Out Posts (BOP) and Customs Offices (CO) have been established. However, border points of Chentang-Kimanthanka and Ri'og-Olangchung have local Border Out Posts (BOP) only to regulate cross border movement. As per findings from field visits at Rasuwagadhi (Rasuwa), a total of 15-20 Armed Police Forces (APF) personnel are on daily duty to guard the border point. Similarly, at Tatopani (Sindhupalchowk), a total of 9-15 Armed Police Forces (APF) personnel are on daily duty to guard the border point. Similarly, the long-range platoon under the Armed Police Force (APF) are responsible for conducting surveillance of border pillars. At present, 5 border pillars out of 17 are accessible in Rasuwa and 3 border pillars out of 9 are accessible in Sindhupalchowk. On the Chinese side, a mixed paramilitary force

11 Ibid.

12 Ibid.

consisting of personnel from the People's Armed Police (PAP), representatives from Immigration and Customs Department and government officials from the County adjacent to the border are responsible for safe-guarding the border.

C1.3 Joint border management mechanism

Border security representatives from Nepal and China have a joint border management mechanism wherein they sit for monthly meetings. This information was disclosed by the District Administrative Offices (DAO) at both Rasuwa and Sindhupalchowk during the field visits. The joint meetings are led by the Chief District Officer (CDO) on Nepal's side while the County representative from Tibet Autonomous Region (TAR) leads the Chinese delegation. The Nepali delegation consists of officials from Armed Police Force (APF), Nepali Police (NP), Nepal Army (NA), Custom Offices (CO) and other local government representatives. Whereas, the Chinese team consists of personnel and officials from the People Armed Police (PAP), and the Chinese Customs and Immigration Department. Common theme of discussion on these meetings ranges from security concerns (border discrepancies), cross-border crimes (illegal exchanges), and monetary and material aid (as required by Nepal's northern districts). Key personnel at Armed Police Force at Dhunche, Rasuwa revealed that the armed police forces from both the countries perform joint patrolling of key border areas including surveillance and safekeeping of border pillars. In addition to the joint meetings, security officials also remain in constant contact via 'we-chat', a social messaging application due to its accessibility in both Nepal and China.

C1.4 Variation in border management due to pandemic

Owing to the Covid-19 pandemic, the monthly border management meeting has been taking place virtually via zoom or on phone calls (using we-chat). Further verified by government officials at District Administrative Offices (DAO) of both Sindhupalchowk and Rasuwa, only once since January 2020 the meeting has taken place physically. The meeting took place under strict Covid-19 protocols on the Miteri Bridge (connecting Nepal and China) with compulsion of PPE suits (Personal Protective Equipment). Since early 2020, the common themes of discussion at the border meetings consist of Covid-19 related aid and assistance, food and material support as needed by local residents along Nepal's northern districts alongside transfer of cargo and truck consignments between Nepal and China's transit points. The same interview had revealed that the inconsistency in the virtual border meetings has paved path to miscommunication and misinformation along the Nepal-China border points with local inhabitants and businessmen facing the biggest burden.

C1.5 Geographical Terrain and its Difficulties

While the geographical structure of Nepal's northern borderland has been heavily credited for low cross-border crimes and issues; the structure has, time and again become a factor of burden to manage cross border security and issues. With most of the Nepal-China border demarcated by border pillars running through high-altitude or riverine, Nepali Armed Police Force (APF) has a hard time surveilling the border. Personnel from Armed Police Force (APF) stationed at both Rasuwa and Tatopani conveyed that the long-range platoons (a special unit under APF that undergoes border pillar surveillance) take more than a week to reach pillars located above 4000 meters from the sea level. Similarly, with limited surveillance tools, survival equipment and necessities to conduct such security expedition, APF personnel at times risk their lives while fulfilling their duty and operation; eventually limiting Nepal's security forces in ensuring smooth border security surveillance, management and operation.

C1.6 Trafficking and smuggling along northern border

The Nepal-China border records many smuggling cases. With most of the border points running through dense forest areas, smugglers have easy access to illegal cross-border movement of goods. Government officials interviewed at both Customs Office in Rasuwagadhi and Tatopani reported that the most common smuggled goods along the Nepal-China border consists of traditional and mountainous herbs, television, gold, pashmina, cordless phones, mobile sets, and red sandalwood. Similarly, Immigration Officers along the same border points also reported trafficking of poor and unemployed border residents' manual labour and trafficking of Nepali woman in sexual activities/ prostitution (particularly at red light areas of Gyirong and Nyalam County at Tibet Autonomous Region).

C2. Flow of people, culture, ideas and goods

Prior to 1950, Nepal's northern border districts had direct relations with Tibet. Both the countries had large scale movement of its citizens across the border for various personal and professional engagements with a thin line of separation differentiating them. With border residents similar in terms of most aspect apart from their nationality, language and living conditions; martial and business relations flourished along the borderline. However, the diplomatic reset of 1950-1960 changed the entire cross-border discourse. With strict border control and monitoring mechanism in place, local cross-border exchanges and engagements extensively reduced.

C2.1 Cross-border relation, mobility & trade – historical perspective

Consultative interviews with local inhabitants staying along the border line of Timure (Rasuwa) and Kodari (Sindhupalchowk) revealed that prior to 1950, there was no concept of border regulation or border check points along the Nepal-China border line. Citizens from both the nations could easily cross the border for local engagements including familial trips, cultural and religious exchange and marriages. This led to the establishment of Nepali community of Shakyas and Vajracharyas of Kathmandu at Khasa (Nyalam County) and of Tamangs and Lamas at Kerung (Gyirong County). Similarly, trade of agricultural and manufactured goods was also rampant; with Nepal mostly exporting goods including green peas, fresh vegetables, tele cotton, shoes, liquor, cigarettes, and salt while importing iron rods, metals and refined cotton. This led to the development of a barter system of trade between the two nations at supermarkets known as 'konshi' on the Tibet side of the border. A household survey with a local businessman at Barahbise (Sindhupalchowk) revealed that Nepali traders back then had more market power and demanded higher market prices for their products at Tibetan markets (in particular konshi). As Tibet is a non-agro producing region, it was heavily dependent on Nepal for most of its daily consumption goods.

Slowly, with increasing Chinese influence on Tibet, the two countries signed the 1956 agreement on Economic Aid. Later visa regulation was also implemented on the movement of local people from between the two nations[13]. Nevertheless, the agreement granted local border inhabitants residing within 30 kilometres (kms) of either side of the Nepal-China border with a 'Special Citizenship Card', allowing them to cross the border at any point of time to engage in small and traditional activities without any visa or passport requirement. The card could be availed by border residents via the immigration office at the border point on the basis of the national citizenship card and allowed free movement within 30 kms of Chinese land from the border point. Nonetheless, border residents were required to register at a border crossing or at a fully recognized government agency of the other country, both on their departure and arrival. On the other hand, common Nepali nationals were required to get visa to enter China via the northern border.

13 http://lcweb2.loc.gov/cgi-bin/query/r?frd/cstdy:@field(DOCID+np0122)

C2.2 Cross-border relation, mobility & trade – prior to Covid-19

Post 1980s, a drastic reversal in cross-border migration was recorded along the Nepal-China border. With stability in Tibet, the autonomous region experienced immense growth in terms of economy and politics. Considering this, much migration at the northern borders consisted Nepalese migrating for better employment and business opportunities. Moreover, Tibet also gained power over the local trading markets (konshi); reducing Nepali traders as mere price-takers in all economic deals.

Weak infrastructural connectivity between the northern borderlands of Nepal with its capital city (Kathmandu) also pushed border inhabitants to depend on employment opportunities across border. For instance, the distance between Timure (Rasuwa) to Kathmandu is 170 kilometres as compared to a distance of roughly 24 kilometers between Timure (Rasuwa) to Gyirong County at Tibet. Hence, Nepali border residents prefer migrating across to Tibet for employment where they are typically involved in cheap labour including – salesmen, porter, labourer, driver, waitressing, cooking and other petty trades. Household surveys at Rasuwa and Sindhupalchok revealed that many Nepali females were engaged in prostitution and sexual activities at brothels along Nyalam and Gyirong County of Tibet under specified red-light areas.

Mobility also happened for religious exchanges. Interviews with local border inhabitants along Rasuwa and Sindhupalchowk revealed that due to close monastic relations between Nepal's northern districts and Tibet Autonomous Region (TAR) of China, migration of Buddhist gurus and in particular of 'Rinpoche' was rampant. While border residents (on Chinese side of the border) are also allowed to travel within 30 kms inside Nepal's territory, at times, people under the pretext of religious exchanges travelled up to Kathmandu, Lumbini and even the Nepal-India border for further migration to Dharamsala (Himachal Pardesh, India). Up until 2007, Tibetans clandestinely crossed the Nepal-India border in order to receive the blessings of their religious leader, the Dalai Lama, or to get a chance to attend a school of their choice. This always irked the Chinese immigration officials and Chinese border security personnel; further restricting the movement of Sherpas and Lamas along Nepal-China border. Suspected of being followers of Dalai Lama or torchbearers of pro-Tibetan movements, descendants of these caste (Sherpa and Lama) were often barred from crossing the Nepal-China border by road, something that other descendants of Tamang and Rai caste did not face.

C2.3 Cross-border relation, mobility & trade – post Covid-19

Since January 2020, the Nepal-China border has remained closed owing to the Covid-19 pandemic to prevent the spread of the virus via inter-state mobility and cargo movement. Consultative interviews at Rasuwagadhi and Tatopani Customs Offices revealed that the Chinese authorities are reluctant to open the transit points primarily due to Nepal's weak Covid-19 protocols, sanitization and quarantine facilities. This has led to the development of a 'hook-and-drop' method wherein trucks from Chinese side of the border bring consignments and drop it along the Miteri Bridge at Rasuwagadhi and Tatopani. The dropped consignment is then picked up by Nepali trucks (which stay quarantined at the border point at all times). At present, there are roughly 30 labourers (loaders and truck drivers) who stay in continuous quarantine along the two border points. The cumbersome method allows only 10-30 trucks to pass the Nepal-China border (on a daily basis), severely hampering Nepali traders and businessmen who previously relied on procuring goods and commodities via China.

This border closure has severely impacted local border residents. Roughly 200 households along Kodari (Sindhupalchowk) and 100 households along Timure (Rasuwa) are facing acute unemployment. Moreover, residents with familial ties across the border have lost their means of communication and interaction. A Nepali porter from Rasuwa who has family at Chinese side of the border revealed that he has no whereabouts of his family and has been unknown about their circumstances since February 2020. Similarly, another Nepali manual labour from Rasuwa conveyed that with drying savings (that he collected from working at Gyirong County of Tibet prior to 2020), he has been selling his assets including jewellery and other liquid-able properties for subsistence.

C3. Chinese foreign aid and assistance – aim and policy

Gradually by the 1970s global experts and scholars formed the opinion that 'proletarian internationalism was the guiding principle of China's foreign policy as well as of her aid to other countries'. Moreover, China's aid to foreign countries was either gratis or in the form of loans on favorable terms, with China regarding it as her internationalist obligation to aid some third world countries in the development of their national economy (Zhou, 1964).

However, as of present, scholars believe that foreign aid is another means employed by China to gain the status of a world power by trying to win a position of supremacy with poor countries and to maintain a competitive spirit with the super powers. In this view, it has been observed that China has used

foreign aid as a tool in diplomatic armoury to compete with western powers without risking war. In case of Nepal, China has aimed to diminish India's influence in Nepal alongside gaining political influence and increasing China's strategic mobility in Nepal's northern borders and make a zone of the Chinese influence.

C3.1 Chinese investment and engagement along Nepal's northern districts - macro

The China International Development Cooperation Agency (CIDCA), China's overseas assistance and development agency has been aggressively making its foray into Nepal; committing to fund prototype development projects in 15 northern districts of the country[14]. Besides this project, CIDCA is also executing projects like improvement of Araniko Highway and the Ring-Road Improvement Project (Phase II)[15]. Alongside CICDA, China has also granted Nepal the access to three Chinese land ports and four sea ports (as under the Transit Transport Agreement signed between the two countries in 2016) (Rajagopalan, 2018).

In FY 2074/2075, Chinese had a total of NPR 38,071 million investments in Nepal's northern border districts, out of which NPR 34,541 million was in Rasuwa, NPR 10 million in Sankhuwasabha, NPR 2000 million in Solukhumbu, and NPR 1520 million in Manang. In Rasuwa, the investments were directed in two hydroelectric power plants of 102 MW and 78 MW capacity. Similarly, the investment in Manang was for the construction of a hydroelectric power plant with a capacity of 100 MW. Likewise, investment in Dhading was directed towards brick industry and vegetable farming.

China was the major investor in Nepal's northern districts during FY 2075/76, with a total investment of NPR 1462.08 million, of which NPR 1047.08 million was in Sindhupalchok – which was directed towards crushed stone and pulverized stone manufacturing company and a construction company. Similarly, NPR 100 million was invested in Humla in carrying out feasibility study of gold, copper, and lead minerals, and NPR 315 million in Dhading to develop steel company and vegetables and fruits farming.

14 Giri, A. (2021b, January 5). China's foreign aid agency is all set to make foray into Nepal's northern region. The Kathmandu Post. https://kathmandupost.com/national/2021/01/05/china-s-foreign-aid-agency-is-all-set-to-make-foray-into-nepal-s-northern-region

15 Ibid.

Later, in FY 2076/77 China invested NPR 57.73 million in Sindhupalchowk in a concrete water reducer and concrete accelerator industry. While the Nepal recorded a steep decline in total FDIs received in FY 77/78 (mainly due to the Covid-19 pandemic)[16], northern district of Dhading recorded Chinese investment of NPR 70 million for construction works.

Table 1: Chinese Investment along Nepal's northern districts over the last four fiscal years.

FDI in Study Areas (in milllion NPR)					
Investor Country	**FY 74/75**	**FY 75/76**	**FY 76/77**	**FY 77/78**	**Total**
China	38071	1462.08	100	70	39703.08

(Source – Department of Industry)

C3.2 Chinese investment and engagement along Nepal's northern districts - micro

In terms of local commitments, the Chinese government has given each of Nepal's 15 bordering districts NPR 3 million (USD 42,500) for the development of their Village Development Committees (VDCs), the local administrative body[17]. Similarly, China has been supporting the construction of a 16 km-long road linking Syaprubesi in Rasuwa with Gyirong County in the Tibet Autonomous Region (TAR) of China. Likewise, a 105-km road from Trisuli to Sombdang (under the Pasang Lahmu Highway) is being improved with support from the Chinese government. Nepal and China also plan to develop cross border roads connecting Simikot-Hilsa (85 km), Jomsom-Korala (80 km), and Khandbari-Kimanthanka (80 km). Moreover, to better facilitate trade and transit between the two countries, China has initiated the construction of dry ports at Larcha in the Sindhupalchok with other dry ports planned to be constructed at Yari-Pulam, Rasuwa-Jilong, Kodari-Zangmu (Khasa), Kimathanka-Dingri, Olangchungola-Riwa, and Mustang-Lingzi[18].

16 South Asia Monitor. (2021, July 21). Nepal: Foreign direct investment drops by 14 percent in FY 20–21. https://www.southasiamonitor.org/nepal/nepal-foreign-direct-investment-drops-14-percent-fy-20-21?gclid=CjwKCAiAhreNBhAYEiwAFGGKPFVu76l3CvjtiCctOtUOddbMV9AMD0bz-9zaVb2_Ds7u204JBPZ_zQxoCVVwQAvD_BwE

17 Human Rights Watch. (2015b, June 16). Under China's Shadow. https://www.hrw.org/report/2014/04/01/under-chinas-shadow/mistreatment-tibetans-nepal

18 Ibid.

Field visits to Rasuwa and Sindhupalchok districts revealed that a 400KV transmission line, a transit grid connecting Mata Tirtha (Nuwakot) via Rasuwagadhi (Rasuwa) to Tibet has been envisioned by the Chinese authorities. However, due to the cumbersome bureaucratic procedures in Nepal, it is yet to kick off. Moreover, since the past few years, the Chinese authorities have begun to focus on maintaining local level engagements. Chinese authorities are aggressively engaging in building schools, tunnels and hydro plants along Rasuwa and Sindhupalchowk to increase people-to-people engagement. Consultative interviews with civil society members at these districts conveyed that at present, there are two Chinese funded schools at Rasuwa (one each at Syaprubesi and Timure) and one Chinese embassy backed school at Barahbise, Sidhupalchowk; with particular courseworks in the Chinese language. Similarly, through constructions and infrastructural development activities, Chinese private construction companies like CRCC (China Railway Construction Company) and GHCB (Guangxi Hydroelectricity Construction Bureau) have been providing employment opportunities to local residents. These companies were found to be operating in northern districts of Rasuwa and Sindhupalchowk after winning the global bidding initiated by the Government of Nepal (GoN).

C3.3 Chinese engagement along Nepal's northern districts – aid distribution

In terms of local aid distribution, consultative interview with government officials of District Administration Office (DAO) at Rasuwa revealed that the Xilong County at Tibet Autonomous Region (TAR) of China and the District Administrative Office (DAO) at Rasuwa have an internal link at official level. This partnership allows the Tibetan government to send relief materials to the district as and when necessary.

While the Ministry of Foreign Affairs (MoFA) at Kathmandu has clearly detailed the protocol for foreign aid and monetary support under the International Development Cooperation Mobilization Policy (IDCMP) (Ministry of Finance, 2019); donation, relief materials and aid to northern districts by China has been allowed to continue with Chinese authorities sending monthly supplements to Nepali border residents without following the protocols and modalities under IDCMP. According to protocols as stipulated in IDCMP under 'Aid Mobilization Modalities', numbered – 3.2.6 states that[19]:

19 Ibid.

Government of Nepal may accept humanitarian assistance, including rescue and relief materials, food assistance, and medicines or medical equipment for the purpose of disaster management and may also request Development Partners for such assistance. Assistance so received will be distributed through mechanisms at the Federal, Provincial and Local levels taking into consideration their immediate needs and capacity.

Consultative interviews with Chief Customs Officer (CCO) at Rasuwagadhi (Rasuwa) and Tatopani (Sindhupalchok) revealed that any local aid (sent by China) has to follow the above protocols, wherein the aid is first sent to Ministry of Finance (at Kathmandu) for tax exemption. Henceforth, the Ministry of Home sends the aid to provinces, districts and areas as per the needs. However, the Chinese authorities have been found donating aid (mostly humanitarian) irrespective of the protocols (i.e., directly to the local governments (ward or village development committee) without prior approval from Nepal's Home Ministry). They have been doing so at geopolitically strategic area, where the Chinese government has strategic and security interest. This was further verified via household surveys at Humla and Kimanthanka where even during the peak pandemic period; food, medicines and other daily necessities were provided by China to Nepal's northern lands. Similarly, interview with local border residents and ward chairperson at Kimanthanka has verified that the border villages of Olangchung Gola, Yanma and Ghansa at eastern Nepal received relief packages including 19,650 kgs of rice, 7135 litre of oil, 1230 kg of flour, 334 packets of milk, 1040 kg milk powder and other medical essentials like sanitizers, PPE and masks during year 2020-2021.

C3.4 Chinese engagement – national and local perspective

The Nepali government sees Chinese investment as a once-in-a-generation economic opportunity. According to a report by the research lab 'Aid Data', Chinese financial diplomacy in various infrastructure projects in Nepal, including road and hydropower, was just under USD 1 billion between the years 2000 and 2017 (Pandey A., 2020). The signing of the Transit Transport Agreement (TTA) in 2016 had significant geopolitical and geo-economic ramifications for the country. The TTA offered Nepal access to seven Chinese sea and land ports and enabled third-country imports and exports thereby removing its near-complete dependency on India (Pandey A. , 2020). Similarly, Chinese investment has also been helmed as a tool needed in eradicating poverty, bringing the countries closer and expediting economic activities and prosperity (Pandey A. , 2020).

On a more local perspective, Chinese engagements along Nepal's northern border districts have been viewed positively by local border inhabitants. With more investment and infrastructural development, local residents have been engaging themselves in small employment opportunities including – loading and off-loading along Chinese built hydro power plants, road construction and repairment and other activities. Similarly, a local respondent from Timure (Rasuwa) also claimed that with Chinese funded schools, children will now no longer need to travel till Dhunce (Rasuwa) for their secondary education. Consequently, local residents are more dependent and satisfied with Chinese engagements as compared to Nepali engagements along Nepal's northern border areas/regions.

C4. Nepal-China border – issues and concerns

As of present, the Sino-Nepal border primarily has two issues and concerns – one around land and pillar discrepancy and another regarding Tibetan sensitivities.

C4.1 Land & pillar dispute

On 21 March 1960, Nepal and China signed a treaty which stipulated that the 'traditional customary line' would serve as a basis for their boundary. After the border survey and demarcation of territory according to the delimitation of the treaty, the joint survey team started erecting permanent pillars and markers, specified from serial number 1 to 79 (from west to east) from June 21, 1962, at various points on the border line. There were 48 large and 31 small size pillars and markers. Apart from this, there were 20 offset pillars constructed where there was a possibility of disappearance of the main pillars due to natural calamities. The total demarcated boundary between the two countries was 1439.18 kilometres (Chakraborty, 2020). Fast forward to today, many reports and scholars has claimed that despite the two countries signing the boundary treaty agreement, Nepal could end up losing hundred acres of land as a result of rapid expansion projects by China (Poudel, 2021). In the recent years, the main loss of land has been observed along northern districts of Sankhuwasabha, Rasuwa, Sindhupalchok and Humla.

The National Investigation Department (NID) has identified 15 border pillars along the Nepal-China border in the Humla district[20]. Findings from interviews

20 Online Khabar. (2021, November 4). Nepal-China border 'dispute': Govt team busy visiting border pillars in Humla - OnlineKhabar. OnlineKhabar English News. https://english.onlinekhabar.com/nepal-china-border-dispute-humla.html

with local inhabitants from Humla has revealed that pillars along Nepal-China border are being shifted with land encroachment intentions by the Chinese authorities. For instance, there are seven pillars (pillar numbers 56-61) along Nepal-China border in the districts of Dolakha within which pillars number 55 has been washed away by the river and pillar number 60 is missing, while China time and again claims that the pillar number 60 has gone missing due to the river.

The biggest border concern lies in Humla where an assessment by the Home Ministry revealed that China had rebuilt and re-fenced certain boundary pillars without Nepal's consent. Similarly, the report also highlights that the Chinese attempted to construct a 145 meters permanent canal inside the Nepali territory[21]. The Ministry of Home Affairs wrote to the Ministry of Foreign Affairs to take up the matter with Beijing. However, China has denied any instances of any border encroachment. The issue in Humla had first surfaced after a committee led by Chief District Officer, Chiranjivi Giri found that China had allegedly constructed nine buildings inside Nepali land[22]. Following the news, Kathmandu locals demonstrated outside Chinese embassy protesting Chinese encroachment[23]. However, Foreign Ministry failed in following up with the Chinese embassy regarding the issue. The denial of China regarding this matter and the unwillingness in taking diplomatic measures by the Home Ministry has further created difficulties in resolving the issue.

C4.2 Pro Tibetan Movement and Tibetan Sentiment

Prior to 2008, Tibetan activist used to demonstrate in front of the Chinese Embassy in Nepal, in front of the UN office, in Boudha and even during Dalai Lama's birthday[24]. Kathmandu became a major centre of pro-Tibetan political action for many months during and after the 2008 uprisings in Tibet, with daily street rallies, meetings, and political events. Post 2008, Pro-Tibetan

21 Giri, A. (2021, October 5). Take up border issue with Beijing, Home Ministry asks Foreign Ministry. The Kathmandu Post. https://kathmandupost.com/national/2021/10/05/take-up-border-issue-with-beijing-home-ministry-asks-foreign-ministry

22 Online Khabar. (2020, September 21). Humla official: China constructed 9 buildings on Nepali land. OnlineKhabar English News. https://english.onlinekhabar.com/china-allegedly-constructed-9-buildings-on-nepali-land-cdo-monitoring.html

23 Online Khabar. (2020, September 23). Demonstration outside Chinese Embassy in Kathmandu 'against encroachment' - OnlineKhabar English. OnlineKhabar English News. https://english.onlinekhabar.com/demonstration-outside-chinese-embassy-in-kathmandu-against-encroachment.html

24 Human Rights Watch. (2015, June 16). Under China's Shadow. https://www.hrw.org/report/2014/04/01/under-chinas-shadow/mistreatment-tibetans-nepal

movement is restricted. Since then, it has become impossible for Tibetans to organise political rallies or gatherings in public place. Tibetan settlements are also tightly restricted by the police[25]. There is a heavy diplomatic pressure to the Nepali government from China to curb Tibetan demonstrations, with the police frequently fighting with protesters or prosecuting Tibetans who are suspected to be involved in pro- Tibetan movement[26].

2015 event – after earthquake

As per a consultative interview with government officials at the Barhabise Municipal Office, after the 2015 earthquake, the entire Khasa market (on Chinese side of Nyalam County) was lifted because the Chinese rescue missions (sent by the Chinese government) found manuscripts and teachings of Dalai Lama on Nepal's side of the border town that got destructed. The border area constituted of Tatopani and the residents of these houses were of Sherpa and Lama descendant. While the Khasa market was shifted inside Nyalam County, 20.1 kms away from the Nepal-China border, citing geographical difficulties; in truth, Sherpas and Lamas (on China's side of the border and other ethnic Tibetans) were forced and shifted under compelling conditions. The same consultative interview also hinted at the probability of these residents being subjected to cruel, inhuman, or degrading treatment, and even torture.

C5. Northern borderland connectivity

China in its engagement along Nepal's northern border districts has been aggressively pushing for the implementation of the Trans-Himalayan Multimodal Connectivity Network under its bigger Belt and Road Initiative umbrella.

C5.1 The Trans Himalayan Multimodal Connectivity Network

The strategic location of Nepal situates itself as a gateway to Trans-Himalayan Economic Corridor linking China with India through rail and road networks across the Himalayas. Nepal signed a framework agreement on Belt and Road Initiative (BRI) in May 2017[27]. The MoU signed by the two countries envisions to enhance connectivity among two countries through investment on ports, roads, railways, aviation and communications under the framework of Trans-Himalayan Multi-Dimensional Connectivity Network (THMCN)[28]. This

25 Ibid.

26 Ibid.

27 Jingxi, M. (2019, October 12). Trans-Himalayan network taking shape. Chinadailyhk. https://www.chinadailyhk.com/articles/32/82/58/1570854766021.html

28 MoFA. (2019, October 13). Joint Statement Between Nepal and the People's Republic of China – Ministry of Foreign Affairs Nepal MOFA. Ministry of Foreign Affairs. https://mofa.gov.np/joint-statement-between-nepal-and-the-peoples-republic-of-china-2/

agreement has remained a basis for Trans- Himalayan connectivity network which is supposed to link China through Nepal with China-Pakistan economic corridor and Central Asia for trade[29].

Within the THMCN framework under the BRI, Trans-Himalayan railway remains a flagship and much hyped project which is supposed to establish train link from Kerung via Rasuwa to Kathmandu and onward to Pokhara and Lumbini. The MoU was signed with the Chinese part for the collaboration on railway project in 21 June 2018 and another MoU was signed in 13 October 2019 for the feasibility study of the proposed project[30]. Added, the agreement signed during Chinese president Xi's visit to Nepal in September 2019 again explicitly included a clause on feasibility study for transboundary railway. This agreement also included two tunnels (to be built) that can connect Kathmandu to Kerung via Himalayas[31]. However, no significant progress has happened since, given the covid-19 crisis and political uncertainties in the Nepal's side; the study about feasibility of the entire project has been halted[32].

Nepal government has selected nine projects to be financed under the BRI initiative. These projects are mainly focused on enhancing the borderland connectivity along Nepal's northern border and hydroelectricity. It includes – upgrading Rasuwagadhi-Kathmandu road, Kimathanka-Hile road construction, road from Dipayal to the Chinese border, Tokha-Bidur road, Kerung-Kathmandu rail, Galchhi-Rasuwagadhi-Kerung 400kv transmission line, 726 MW Tamor hydroelectricity project, 426 MW Phukot Karnali hydroelectricity project and Madan Bhandari Technical institute. Recently, Ministry of Foreign Affairs led other ministries to develop the implementation plan for the proposed project under the THMCN which for negotiations with China regarding the final project selection, funding mobility, budget, supervision and monitoring and human resource management[33].

29 Xinhua. (2017, May 12). Nepal, China sign bilateral cooperation agreement under Belt and Road Initiative - Xinhua | English.news.cn. Xinhuanet. http://www.xinhuanet.com/english/2017-05/12/c_136276949.htm

30 MoFA. (2019, October 13). Joint Statement Between Nepal and the People's Republic of China – Ministry of Foreign Affairs Nepal MOFA. Ministry of Foreign Affairs. https://mofa.gov.np/joint-statement-between-nepal-and-the-peoples-republic-of-china-2/

31 Center for Nepal and Asian Studies. (2020, September 25). With Promises of a Trans Himalayan Link, China Grows Influence in Nepal – CNAS. https://cnastu.edu.np/2020/09/25/with-promises-of-a-trans-himalayan-link-china-grows-influence-in-nepal/

32 Giri, A. (2021, August 27). With new dispensation in Kathmandu, talks resume on projects under BRI. The Kathmandu Post. https://kathmandupost.com/national/2021/08/27/with-new-dispensation-in-kathmandu-talks-resume-on-projects-under-bri

33 Ibid.

Earlier to this, in September 2018, in the eve of announcement of Trans-Himalayan Connectivity Network, Nepal signed Transit Transport Agreement (TTA) which facilitates Nepal's access to – four seaports (Tianjin, Shenzhen, Lianyungang and Zhanjiang) and three land ports (Lanzhou, Lhasa and Xigatse) in China (Panda & Sarkar, 2019). During President Xi's visit to Nepal in 2019, China also agreed to reopening and restoration of Zhangmu/Khasa port and optimize the functioning of Jilong/Keyrung port and open the Lizi/Nechung port[34]. Earlier in 2018, during KP Oli's visit to China, both countries agreed to cooperate in developing three north-south connecting corridors in Nepal, namely, Koshi Economic Corridor, Gandaki Economic Corridor and Karnali Economic Corridor[35].

C5.2 Concerns regarding funding modality

Although Nepal officially signed BRI in 2017, it has not implemented any projects under BRI framework. It is stated that China wants to select the projects first, for which Nepal is preparing implementation plan for nine prioritized projects to be executed under BRI, before holding discussions in funding modalities and negotiations[36]. Also, the funding modality for much buzzed Trans-Himalayan railway network is not clear. Officials claim that while Nepal is negotiating for grants on the project to be implemented under China's flagship BRI, China is insisting on the soft loans[37]. Given Nepal's miniature economy, this raises question on Nepal's affordability to pay back loans and the consequences if not paid, leading to debt trap (Pasricha, 2019).

C5.3 Trans-Himalayan Network as China's foreign policy instrument

The THMCN initiative has come in a scenario when China is trying to extend its influence in South Asian region. China's concern of transboundary connectivity is not the sole economic concern, but largely geopolitical and strategic. Given Nepal's size of economy and comparatively small market for Chinese manufacturing sector, it does not hold significant economic rationale to invest in very costly transboundary railway network through Himalayas that

34 MoFA. (2019, October 13). Joint Statement Between Nepal and the People's Republic of China – Ministry of Foreign Affairs Nepal MOFA. Ministry of Foreign Affairs. https://mofa.gov.np/joint-statement-between-nepal-and-the-peoples-republic-of-china-2/

35 ibid

36 Giri, A. (2021, August 27). With new dispensation in Kathmandu, talks resume on projects under BRI. The Kathmandu Post. https://kathmandupost.com/national/2021/08/27/with-new-dispensation-in-kathmandu-talks-resume-on-projects-under-bri

37 Ibid.

terminates only within Nepal. As China and Nepal both has agreed to extend proposed Trans-Himalayan railway line to Lumbini, China's far-sighted aim to connect to the populous Indian market of Uttar Pradesh, Uttarakhand, Bihar and West Bengal cannot be sidelined[38].

C5.4 Feasibility of regional network and prospects for Nepal

Although the MoU has been signed for transboundary railway network connecting Tibet to Nepal, given the high-altitude mountainous geography, it holds massive geological and engineering complications over the successful execution of the project (Pasricha, 2019). While the pre-feasibility study of the project signals the transboundary rail link is feasible[39], the construction might take years to complete and requires massive investment. Given the successful execution of this transboundary connectivity network along with the proposed tunnel road connecting Kerung to Kathmandu, it is projected that it would lower the dependence of Nepal on India, allowing access to trade routes except through India. The Trade Transit Agreement has already provided Nepal with access to seven Chinese ports; opening the wider prospect of reduced dependence on India for international trade. However, there remains the issues of operationalization and practicality of the access to the Chinese ports, given the proximity and topography in accessing the ports.

Experts state that the transboundary connectivity project opens up the vast market on the Chinese side by easing swift movement of goods between the two countries. Furthermore, the Trans-Himalayan connectivity network enables Nepal to be the center of economic corridor and civilizational bridge between the northern India and Tibet as a transit hub along with linking China-Pakistan Economic Corridor and Central and Southeast Asia (Rana M. S., 2017; Pasricha, 2019).

D. ANALYSIS AND CONCLUSION

China's engagement along Nepal's northern border has undergone a unique transformation over the years. Looking at it historically, prior to 1950, Nepal shared its norther border with Tibet with close religious, cultural, monastic and socio-economic ties. Back then, the two nations shared an open border with unrestricted access to migration, trade and cross-border activities. However, the

38 Wagle, A. (2018, June 26). New trans-Himalayan dictum. The Kathmandu Post. https://kathmandupost.com/opinion/2018/06/26/new-trans-himalayan-dictum

39 Tibetan Review. (2020, January 26). Nepal clears pre-feasibility report for railway link with China via Tibet. https://www.tibetanreview.net/nepal-clears-pre-feasibility-report-for-railway-link-with-china-via-tibet/

period between 1950-1960 saw major bilateral and diplomatic reset between Nepal and her northern neighbour. China's increasing influence over Tibet pushed Nepal to establish diplomatic ties with Beijing alongside singing numerous bilateral, friendship and boundary demarcation agreements. This drastically reduced the once flourished and rich cross-border dynamics and engagements (people-to-people) between Nepal's northern border and Tibet while increasing national-level engagements and exchanges (state-to-state) between Nepal and China.

As of today, China's increasing interest and engagement in Nepal has increased economic and development opportunities for the latter while ensuring geopolitical wins for the former. With increasing foreign aid, assistance, soft and hard loans and infrastructural connectivity, China's ambition of developing Nepal as a transit hub to accelerate its projects under the Belt and Road Initiative has been on a full swing. Considering this, Nepal has a lot to gain in terms of her economic and infrastructural development. However, the capital (Kathmandu) has failed in prioritizing northern borderlands (northern border districts) from its growth trajectory. Moreover, low capital allocation and budget disbursement, weak growth rate, low employment prospects, meager infrastructural development (roadways and other connectivity) and low literacy rate have plagued the northern border districts. Similarly, trade and transit points along the Nepal-China border are also largely absent in the national development discourse. With only two trade and transit points – Rasuwagadhi-Kerung and Tatopani-Khasa operating (marginally); cross border trade, migration, exchanges and engagements along four other border points – Burang-Yari, Lizi-Nechung, Chentang-Kimanthanka and Ri'og-Olangchung are yet to be utilized. However, border infrastructures on Chinese side of the border at Burang-Yari (Humla) and Lizi-Nechung (Mustang) has been initiated, signaling Chinese aim of strategically connecting with South Asia via these border points under the bigger Belt and Road Initiative (BRI).

This study has analyzed that pro-Tibetan activities (Tibetan sensitivities and Tibetan sympathizers) alongside the strenuous geographical structure and terrain along Nepal-China border and the fear of Covid-19 pandemic are the major areas of concern between the two nations in border security and management. While the government of Nepal has time and again in several bilateral meetings, diplomatic understandings and high-level delegation visits re-affirmed to China's 'One China Policy'; presence of Dalai Lama sympathizers and followers along the Nepal-China border has irked the Chinese authorities. This was further intensified during the aftermath of the 2015 earthquake when

the Chinese rescue operation team found pictures, manuscripts, teachings and prophecy of Dalai Lama inside houses of border residents, particularly along Tatopani-Khasa border point.

While on the surface level, the geographical difficulty and damages and dangers posed by the earthquake was cited as the main reason for the border closure (along Tatopani-Khasa border point); the presence of manuscripts in damaged houses along Nepali side of the border increased suspicion among Chinese officials regarding an uprising of Tibetan sensitivities along the said border region. It can be said that both these events contributed to the closure of the border points, triggering the Chinese government to relocate the Khasa market/ settlement up into Nyalam County at the Tibet Autonomous Region (TAR)[40]; to reduce cross-border relation and engagement of Chinese national with local border inhabitants on Nepali side of the border.

Similarly, with most border passing through high-altitude and unreachable elevation, joint border security mechanism and protocols have often failed in regulating cross border dynamics, further giving rise to illegal methods of cross-border migration and exchanges and smuggling of goods and animals. Likewise, weak immigration mechanism has allowed trafficking of labour and women into Tibet into abusive and unsafe work activities. This has severely hindered cross border dynamics and has further portrayed Nepal government as inefficient in managing, monitoring and controlling cross-border migration and mobility.

Another noticeable change along Nepal-China border has been noticed in cross-border trade and exchanges particularly owing to the Covid-19 pandemic. While the volume of trade between Nepal and Tibet had significantly changed over the years with northern border districts importing more as compared to its exports; since early 2020, the discourse has further worsened with Nepal barely receiving 5-10 trucks (on a daily basis) of goods and consignments from China. The Nepal-China border closure has also rendered many local border residents to enter into involuntary unemployment. This has impacted their economic status and considerably reduced their standard of living. Similarly, businessmen and traders along the border line too are facing heavy losses with some even diverting their consignments to Indian ports to continue their business.

40 Nepali Times. (2015, September 8). Tibet relocation | From the Nepali Press. http://archive.nepali-times.com/article/from-nepali-press/relocating-from-khasa,2584

This study also analyzed the investment and engagement of foreign nations (in particular of China, USA and India) in Nepal's northern border districts. While China definitely has a larger share in terms of foreign aid and assistance and contributes around 90% of the total share of FDI received by Nepal's northern borderlands, the USA and India too in the recent years have been accelerating their presence in Nepal's northern district; further adding up to the geopolitical rivalry and significance of the region. As per data from Nepal's Department of Industry (DoI), in FY 76/77, the USA was the major investor with a total investment of NPR 4073.9 million in Taplejung district to construct a hydroelectricity plant with a capacity of 23 MW. Likewise, India invested NPR 100 million in Sindhupalchok district in a hydropower of 36 MW. This indicates the increasing interest of third nations in Nepal's northern border district considering its strategic location. Furthermore, China's aggressive push for projects under the Trans-Himalayan Connectivity Network's umbrella seems questionable considering Nepal's weak infrastructural and logistics capacity to absorb the infrastructural and development activities envisioned by it.

Discrimination, exclusion and restriction on the freedom of movement of Sherpa and Lama descent along the Nepal-China border has severely prevented them from enjoying their human rights. It is mainly because of their close cultural and traditional beliefs between the Sherpa and Lama (across the two borders) that China sees them as Tibetan or more clearly put – threat to their national security concerns. Consultative interviews and field surveys also concludes that Lama and Sherpa are restricted visa to enter China via border points as China considers them having 'secessionist idea'. Moreover, their freedom of movement is also restricted by the requirement that they register their details while travelling outside the district and are at high risk of torture and ill treatment. Thus, Dalai Lama reverie people are viewed to be suspicious along the Nepal-China border line and China's worry about Tibet and the security threat of unlawful border exit-entry actions has always been their major security concern along the Nepal-China border line.

The Covid-19 pandemic and the subsequent lockdown has affected the locals along Nepal-China border, immeasurably. Under the provision of Special Boarder Citizenship Card, the locals border residents could easily cross the Nepal-China border for personal and professional endeavours. However, at present no one is allowed to cross the border from both the side adversely impacting the local livelihood, consumption and employment among border residents.

Consultative interviews and field surveys further revealed that girls as young as 13 years old are eager to make Special Boarder Citizenship Card to cross the border for 'easy money or quick money'. Under the pretext of working at hotels and households, girls cross the border to end up in brothels and other sexual transactions. While it can be anticipated that the number of minor girls from Rasuwa working as a sex worker has decreased due to closed border; such engagement is still dangerous considering the nature of the occupation. Accordingly, organizations including – Maiti Nepal, Shakti Samuha and Umbrella Foundation are located at the border to facilitate women who cross the border and in particular to regulate their mobility; yet their security has not been prioritized.

E. RECOMMENDATIONS

This report recommends the following as a measure to strengthen and facilitate cross-border movement, exchange and engagement between Nepal and China.

1. Build stronger border security and management mechanism by increasing the presence of Border Out Posts (BOP), Custom Offices (CO), Immigration Offices (IO), Armed Police Forces (APF) and Nepal Police (NP) along all border points between Nepal and China.
2. Update previous boundary agreements, boundary demarcations, and other border protocols and treaties to mitigate or avoid any future border encroachment or pillar disputes. Facilitate border security personnel by providing up-to-date surveillance and patrolling equipment's and tools.
3. Strengthen bilateral mechanism and understandings to ease cross-border engagements and dealings. Advocate joint patrolling of border between Nepali Armed Police Force and Chinese People's Armed Police for better border security.
4. Introduce modern custom rules and protocol to digitize custom protocols. Replace the current manual process to a more digitized one to ease trade via trade and transit points.
5. Increase surveillance via digitization of immigration offices to reduce cross-border crimes and illegal operations (including mobility, transaction and trade).
6. Develop consistency within the Special Citizenship Card provisions for border residents; allowing them to cross the Nepal-China border for cross-border engagements. Ensure their rights to livelihood and residency as secured by the Citizenship Card.
7. Increase presence of central government at strategic border points

between Nepal and China via tools of legal apparatus. Increase women leadership in local governments along northern border for better representation and better security of women who engage in cross-border activities.

8. Establish clear modalities for project under the Belt and Road Initiative (BRI). Develop the Standard Operating Procedures (SOP), funding/ investment modalities and implementation modalities without compromising on Nepal's national interest.
9. Expand and modernize infrastructural connectivity to the northern border districts via North-South Corridor i.e. – Koshi, Gandaki and Karnali corridor.
10. Government of Nepal should negotiate strongly for proper implementation of protocols under the Transit Transport Agreement (TTA) for Nepal's use of 4 Chinese sea ports and 3 Chinese dry/land ports.
11. Attract Chinese private investors in infrastructural development of Nepal via tools of investor confidence and favorable investment environment across Nepal's politico-economic realm.
12. Stick to China's 'one China policy' to deal better with the issue of Tibet and Tibetan refugees sensitively.
13. Avoid future border blockades on transit points via stronger lobbying by bureaucracy and local governments and adoption of standard quarantine and health safety protocols along northern transit points.
14. Facilitate people-to-people engagement and relations by ensuring easy access to cross-border movements. Recognize the special cross-border relation of people living in the bordering districts before introducing any border management practice relating to cross-border mobility that directly impact peoples' livelihood.
15. The law on cross border employment must be gender friendly so that women are encouraged to work and generate autonomy over their lives. Gender friendly policies are also needed to facilitate education and employment opportunities.

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Chapter 4

Nepal China Transit Transport Agreement: An Analysis

Shraddha Ghimire[1]

A. BACKGROUND AND INTRODUCTION

Nepal has been a member of the World Trade Organization (WTO) since 23 April 2004 and ever since has been conducting trade with third countries across the world as per the WTO principles[2]. As one of the 12 landlocked countries in the Asian continent, the country has been dependent on its neighboring countries to further its international trade. Nepal's total trade with the rest of the world (as percentage of GDP) for the time period between 2011 to 2020 has been on an expanding path, increasing from 36.2 percent to 40.6 percent[3]. Looking at its trade balance during the same period, the country saw a steep rise in its import of goods and services as compared to its export of goods and services. Nepal's import of goods and services increased from USD 6.45 billion to USD 10.68 billion[4]; whereas its export of goods and services drastically reduced from USD 1.86 billion to USD 1.70 billion between 2011 to 2020[5].

Trade, transit and transportation through Indian Plains has been an impeccable factor for Nepal's growing trade with the outside world. India itself is the top import and export partner for Nepal registering a market share of around USD 420 million and a partner share of 56.72 percent (as of Nepal's Total Trade Statistics 2018)[6]. Nepal was able to achieve this feat due to the transit and

1 With Contributions from Arpan Gelal

2 WTO. (n.d.). WTO | Nepal - Member information. World Trade Organisation. https://www.wto.org/english/thewto_e/countries_e/nepal_e.htm

3 The World Bank. (n.d.). World Development Indicators | DataBank. https://databank.worldbank.org/reports.aspx?source=2&country=NPL#selectedDimension_WDI_Series

4 ibid

5 ibid

6 World Integrated Trade Solution. (2017). Nepal Trade | WITS Data. https://wits.worldbank.org/countrysnapshot/en/NPL

transport agreements that it signed with India over the years. The two countries signed different transit treaties in the years – 1971, 1978, 1996, 2002 and 2009 (Chand, 2018). These legal agreements allowed Nepal to use Indian transit (roadway, railway and sea ports) to further its international trade via India. Naturally India became the most important transit and transport partner for Nepal in terms of proximity, open-border, language, people, culture, religion, social system, and so on.

However, in the recent years, trade, transit and transportation activities via China (through Tibetan plateau) has also become an integral part of Nepal's international trade. As of 2018, China was the second largest trading partner for Nepal; with Nepal's exports to China crossing roughly over USD 23 million. Contrary to its exports, Nepal's imports from China were above USD 1.5 billion during the same review period[7]. While, the two countries have signed a number of treaties and understanding to further their transit and trade relations; most of the treaties have failed to reach their objectives.

Initially Nepal and China had signed a transport agreement that allowed transport of goods and people between Lhasa and Kathmandu. Later in 2004, a passenger bus service (from Lhasa to Kathmandu) was also agreed upon; however, this could only last for two months as the Chinese officials stopped issuing visa (citing reasons such as road improvement)[8]. Fast-forward to 12 years, Nepal and China signed the historic transit and transport treaty in 2016[9] that solidified Nepal's transit and transport relations with China. A text to the Protocol to the Treaty was also signed in 2018[10]. However, in spite of signing these treaties, all of them have lacked proper implementation. Nepal and China have agreements and treaties in place but its execution has always been far from realization.

7 MoFA. (n.d.). Nepal-China Relations – Ministry of Foreign Affairs Nepal MOFA. Ministry of Foreign Affairs. https://mofa.gov.np/nepal-china-relations/

8 Acharya, P. R. (2016, March 28). Transit Transport Agreement should be utilised to enhance economic engagement between Nepal and China. The Himalayan Times. https://thehimalayantimes.com/business/transit-transport-agreement-utilised-enhance-economic-engagement-nepal-china

9 The Kathmandu Post. (2016, March 23). Nepal, China issue 15-point joint statement (Read full text). The Kathmandu Post. https://kathmandupost.com/national/2016/03/23/nepal-china-issue-15-point-joint-statement-read-full-text

10 Giri, A. (2018, September 7). China allows Nepal access to its ports, ending Indian monopoly. The Kathmandu Post. https://kathmandupost.com/national/2018/09/07/nepal-china-finalise-text-on-transit-protocol

A1. Overview of Nepal-China Transit Transport Agreement (TTA)

The Nepal-China Transit Transport Agreement (TTA) was in negotiation between the government of Nepal and China since early 2000s but had failed to gain any prominence until the 2015 blockade that Nepal faced along its Southern border points[11]. The 2015 blockade on Nepal-India border points made Nepal realize the need for an alternative transit and transport route for third country trade. At that time, TTA was welcomed from all aspects. Seen as a measure to avoid the on-and-off blockades that Nepal was facing along its Southern borders, the agreement was hailed as a relief to these disturbances. It was one of Nepal's long-term vision to reach out to East Asian markets. However, five years since the inception and signing of the agreement, not a single cargo consignment has been imported or exported via the agreed Chinese routes. This has raised questions regarding the Nepalese government's inertia and disinterest in pursuing the agreement and facilitating its implementation[12]. It also suggests the existence of geopolitical tensions in the region which might be impeding the smooth execution of the agreement.

Nepal has ideally enjoyed a cordial relationship with its two neighbors, India and China. Traditionally, Nepal has transported goods and consignments to and fro with the third countries via Kolkata port in India. The transit treaty between Nepal and India, 'The Treaty of Trade and Transit' was signed in 1960, which recognized Nepal as a land-locked country that needed access to and from the sea to promote its international trade, and to facilitate the traffic-in-transit via each other's national territories (Taneja et.al., 2016). As per the treaty, India had allotted Nepal four out of the twenty-one until then used trading posts for both transit and bilateral purposes. However, in 1989, India had imposed a fifteen-month long unofficial economic embargo on Nepal which denied Nepal access to Kolkata port facilities alongside closing nineteen out of the twenty-one border transit points[13]. Twenty-six years later (in 2015) another undeclared economic embargo was experienced by Nepal along its southern

11 This section is based on the consultative meeting with former commerce secretaries and joint secretaries of government of Nepal.

12 Giri, A. (2021, July 11). Nepal's transit deal with China makes no headway even after five years. The Kathmandu Post. https://kathmandupost.com/national/2021/07/11/nepal-s-transit-deal-with-china-makes-no-headway-even-after-five-years

13 Crossette, B. (1989, April 11). Nepal's Economy Is Gasping as India, a Huge Neighbor, Squeezes It Hard. The New York Times. https://www.nytimes.com/1989/04/11/world/nepal-s-economy-is-gasping-as-india-a-huge-neighbor-squeezes-it-hard.html

border points[14], which heavily affected different sectors of the latter's economy. This embargo resulted in exports plunging by 25.4 percent (NPR 16.81 billion), alongside imports plummeting by 31.9 percent (NPR 130.94 billion)[15]. While the Indian government repeatedly denied their involvement in the embargo, citing that the supply shortages were imposed by Madhesi protesters within Nepal; more than 400 Indian origin trucks and consignments were left stranded at the border (on a daily basis), heavily impacting the entry of perishable goods, petroleum, medicines, gas cylinders, earthquake relief materials among others[16].

The grave difficulties faced by the Nepalese economy due to shortages in essential goods and commodities pushed the government to search for an alternative to Nepal's dependency on Indian transit via Chinese routes which led to the signing of the 'Transit Transport Agreement' by Nepal and China in 2016. The text to the protocol of the agreement was finalized in 2018 after three rounds of consultative meetings[17], marking a historical milestone in the bilateral relations between the two nations. As per the protocol, China formally agreed to provide seven transit points – four sea ports (which includes Tianjin/Xingang, Shenzhen, Lianyungang, and Zhanjiang) and three land ports (Lanzhou, Lhasa, and Xigatse) to Nepal for its third country trade. China also agreed to provide permits to trucks and containers ferrying Nepal-bound cargo to and from Xigaste in Tibet. Likewise, Nepali traders were also allowed to use any mode of transport – roadways or railways to access sea ports as well as dry ports, alongside accessing Chinese territory from six border checkpoints in Nepal[18].

The transit protocol was primarily signed to reduce Nepal's dependency and sea burden from Indian ports (Kolkata, Haldia and Vishakhapatnam) to Chinese ports and to avoid any disruptions in imports of goods and commodities due to unforeseen embargos on border transit points. However, despite the transit transport agreement being formalized, it has not been able to yield its expected

14 Rawal, T. (2015, October 15). Scenario Post New Constitution. SpotlightNepal. https://www.spotlightnepal.com/2015/10/15/scenario-post-new-constitution-2/

15 The Kathmandu Post. (2015, November 24). Exports, imports dive due to unofficial trade embargo. The Kathmandu Post. https://kathmandupost.com/money/2015/11/24/exports-imports-dive-due-to-unofficial-trade-embargo

16 The Kathmandu Post. (2015, November 22). 'Over-reliance on India has hit economy hard.' The Kathmandu Post. https://kathmandupost.com/money/2015/11/22/over-reliance-on-india-has-hit-economy-hard

17 Online Khabar. (2018, July 29). Nepal invites China to finalise Protocol of Transit and Transport Agreement. OnlineKhabar English News. https://english.onlinekhabar.com/nepal-invites-china-to-finalise-protocol-of-transit-and-transport-agreement.html

18 Acharya, P. R. (2018, September 7). Nepal to use Chinese sea, land ports. The Himalayan Times.

outcome in facilitating transit and transportation issues till date. Moreover, recent research shows that due to the Covid-19 pandemic, Nepali traders and businessmen have not been able to utilize the northern transit routes since January 2020[19]. Out of the six transit routes between Nepal and China; Rasuwa and Tatopani have been operating negligibly over the past two years, suggesting the presence of a soft economic closure on northern transit points. Citing the spread of the Covid-19 pandemic as an excuse, Chinese authorities have allowed only four to five trucks of cargo consignment to pass and enter Nepal daily; allowing only five percent of the previous total cargo to enter Nepal through the northern transit points[20].

All these circumstances have left Nepali traders and businessmen with no other alternative but to depend back on Indian ports for third country trade, transit and transportation facilities. Similarly, a media report has cited that more than seventy percent of importers have now started to re-route even the import of Chinese manufactured goods via Kolkata port. Moreover, the lack of initiation by both the Nepalese and Chinese governments to reopen transit routes along the Nepal's northern border has further escalated geopolitical tensions in this region, with Nepali businessmen facing the biggest economic blows.

A2. Objectives of the Study

The progress of the 'Nepal-China Transit Transport Agreement' in procuring both Chinese origin goods and third-country cargo inside Nepal seems dismal from the view point of Nepalese businessmen, traders, trading houses, and trade associations. Considered as one of the biggest political commitments, five years down its inception, not a single Nepal-bound cargo has been imported via the four promised Chinese sea ports. Moreover, the Covid-19 pandemic has further disrupted the existing transit and transport operations (both partially and completely) along Tatopani and Rasuwagadi border points. Envisaged as a research study, this paper aims to provide information and analysis, and recommend key steps to the concerned authorities to assist them in internalizing and capitalizing the agreement. The major objectives of this research study include-

a. Review the objective of and progress on the 'Transit Transport Agreement' and identify the factors hindering its effectiveness.

19 Ghimire, C. (2021, July 18). Opinion | Streamlining Nepal's trade competitiveness. The Kathmandu Post. https://kathmandupost.com/columns/2021/07/18/streamlining-nepal-s-trade-competitiveness

20 Jha, H. B. (2021, March 16). Thaw in Nepal's relations with China. Https://Www.Orfonline.Org/Expert-Speak/Thaw-Nepal-Relations-China/. https://www.orfonline.org/expert-speak/thaw-nepal-relations-china/

b. Ascertain why Nepal is facing a border closure along its Northern borders since January 2020 and determine the volume of loss caused by this soft embargo.
c.` Review the response from both the governments with respect to solving the soft embargo.

A3. Approach and Methodology of the Study

Desk Research and Review of Existing Literature

This paper includes a thorough desk research and review of literature to track down all useful existing pre-published information from primary sources as well as secondary sources including the document- 'Nepal-China Transit Transport Agreement' itself, transit and trade assessment reports on Nepal, transit and transport facilitation documents as available in Nepal, transit and transport policies, government reports, joint statement from high-officials' visits, scholarly articles, journals and media reports, interviews of officials published in media, and websites of both public and private bodies that work closely in facilitating transit issues.

Key Informant Interviews

The process of qualitative survey was carried out through Key Informant Interviews (KIIs), which focused on gathering information and stakeholder opinions on needs and priorities. The questionnaires also explored themes like impacts and vulnerabilities of transit and transport agreements. Keeping in mind the limitations exerted by the Covid-19 pandemic, the consultations were held via online platforms like zoom. The information collected were imperative in substantiating and validating all the previous sources of literature, desk research and data collected from the government's yearly trade reports and statistics.

Data Analysis

All information received from the qualitative surveys (desk research, literature review, and key informant interviews) were thoroughly analyzed to write the report. The data analysis considered all factors as such economic and social transaction (at the local level) followed by state-level transaction and engagements between Nepal and China. Moreover, interactive discourses and dialogues with relevant stakeholders also formed a part of the analysis to extrapolate the report.

B. MAJOR FINDINGS

B1. Key Highlights of the Transit Transport Agreement

Transit Transport Agreement

(Signed by Foreign Ministers of Nepal and China on 21 March, 2016 in Beijing, China)

- Nepal and China shall provide each other with the freedom of transit across their respective territories through routes mutually agreed upon.
- Nepal and China shall have the right to take all indispensable measures to ensure that the transit activities on its territory does not infringe its legitimate interests of any kind or facilitate transnational crimes such as money laundering or arms smuggling.
- The agreement won't bar the parties in taking measures to protect their security interests.
- To protect legitimate interests, the parties will adopt transit and trade restrictive measures.
- Transit transport means traffic-in-transit, covering passage of goods across the territory (land, inland waters, seas) of the party, with the passage being a portion of a complete journey which begins or terminates within the territory of the other party.
- The agreement allows the establishment of permanent facilities on its territory for assembling, dis-assembling or re-assembling.
- Parties can use railway rolling stock, road vehicles, vessels and other transport means as agreed.
- Cargo and goods in transit shall be exempt from custom duties, transit duties, and deposits for the payment of these taxes of transit state if the customs and relevant quarantine and inspection departments of the parties agree that the transit transport procedures are met.
- To facilitate transit transport, parties (after mutual agreement) will provide at points or point of entry or exit, warehouses or sheds, for storage of transit goods awaiting customs clearance before onward transmission.
- Transit transport shall be subjected to procedures agreed by both parties in compliance with relevant laws and regulations of their country alongside international treaties.
- Merchant ships sailing under the flag of Nepal shall be accorded to the laws of China with treatment no less than those given to ships under other country.
- The agreement does not bar parties from pursuing international convention related to export & import of narcotics, psychotropic

substances, animal & plant quarantine objects or pursuance intended to prevent infringement of copyright or trademark right, false marks, counterfeits etc.

- Parties will consult each other for smooth implementation of the agreement and amend upon consensus reached.
- Modalities, routes, conditions of transit, customs can be reviewed or modifies by parties under mutual agreement.
- Disputes to be settles by mutual consultations.
- Agreement to come in force after signing and to be renewed every 10 years.

Text to the Protocol to the Transit Transport Agreement

- Nepal and China shall provide each other with the freedom of transit across their respective territories through routes mutually agreed upon.
- Nepal and China shall have the right to take all indispensable measures to ensure that the transit activities on its territory does not infringe its legitimate interests of any kind or facilitate transnational crimes such as money laundering or arms smuggling.
- The agreement won't bar the parties in taking measures to protect their security interests.
- To protect legitimate interests, the parties will adopt transit and trade restrictive measures.
- Transit transport means traffic-in-transit, covering passage of goods across the territory (land, inland waters, seas) of the party, with the passage being a portion of a complete journey which begins or terminates within the territory of the other party.
- The agreement allows the establishment of permanent facilities on its territory for assembling, dis-assembling or re-assembling.
- Parties can use railway rolling stock, road vehicles, vessels and other transport means as agreed.
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parties in compliance with relevant laws and regulations of their country alongside international treaties.

- Merchant ships sailing under the flag of Nepal shall be accorded to the laws of China with treatment no less than those given to ships under other country.
- The agreement does not bar parties from pursuing international convention related to export & import of narcotics, psychotropic substances, animal & plant quarantine objects or pursuance intended to prevent infringement of copyright or trademark right, false marks, counterfeits etc.
- Parties will consult each other for smooth implementation of the agreement and amend upon consensus reached.
- Modalities, routes, conditions of transit, customs can be reviewed or modifies by parties under mutual agreement.
- Disputes to be settles by mutual consultations.
- Agreement to come in force after signing and to be renewed every 10 years.

B2. Chinese routes were additional and not alternative

Chinese routes were not explored to replace nor to reduce Nepal's dependency on Indian routes, but rather to give India a stiff competition with regards to Nepal's transit and transport opportunities. Consultative interviews with relevant stakeholders have revealed that the TTA (between Nepal and China) was signed to secure additional transit and transport routes via China to the pre-existing Indian ones. Chinese routes were deemed additional routes as they are not feasible for most seasons of the year whereas Indian routes are more dependable, cheaper and shorter. Nepal is linked with mainland China via the Tibet Autonomous Region (TAR) which is known for its varied topography and mountainous ranges averaging more than 4,000 meters in elevation[21]; making it very difficult to build road or rail connectivity. The TTA had allowed for roadway and railway network through this very difficult plateau. However, with assumption that infrastructures would be built, TTA was signed, with Chinese routes to be used only when transit and transport routes via Indian territory were obstructed (particularly in times of economic embargos).

21 EMBASSY OF THE PEOPLE'S REPUBLIC OF CHINA IN THE FEDERAL DEMOCRATIC REPUBLIC OF NEPAL. (2004, October 27). Geography. https://www.mfa.gov.cn/ce/cenp//eng/Features/xzwt/Geography/t167859.htm

As an additional route, TTA was envisioned to bring in goods from the East Asian Market including South Korea, Japan, Taiwan, Hong Kong, and so on, bringing in immense profit for Nepal to cash on. Through Chinese routes, goods from Hong Kong, Taiwan, South Korean, and Japan were estimated to enter Nepal via Tianjin-sea port and Lanzhou dry port within 15 days as compared to Indian routes (which stops for maritime traffic at Sri Lanka and takes 40-45 days, significantly reducing time management cost)[22]. Routes under TTA were also anticipated to bring in goods from the USA, Europe, and Western countries, via the Pacific Ocean and the Chinese sea ports. Additionally, the agreement was also signed to internalize the railway routes (across Eurasia) that China aims to build under the larger Belt and Road Initiative (BRI). Among South Asian (SA) countries, Pakistan is most expensive transit partner/route for Nepal; it is around 400 times costlier to trade with Pakistan as compared to any other SA nations. But with routes under BRI, particularly the Karakorum route (spanning India, Pakistan, and China), expenses were assumed to reduce by a huge margin, making it easier for Nepal to import goods from western countries via Pakistani ports (particularly Gwadar port)[23].

B3. Unclear modalities and procedures

Till date not much progress has been achieved by the TTA. Unclear modalities and procedures are the major hindrances affecting the implementation of the agreement. Most of the modalities and procedures signed in the agreement were mostly based on assumptions that infrastructural development would complete along the Nepal-China border points within a few years from signing of the agreement; however, with no infrastructural development, transit and transport facilities have little scope of being utilized.

The provisions laid in the agreement are unclear and need more clarification. For instance, the detailed modality of cargo movement (whether containerized traffic or general/bulk traffic), its movement from Chinese ports towards Nepal-China border, the real operational modality for the movement of cargo (either export or import), detailed processes involved at the Chinese sea ports, delivery of imports and consignments from East Asia to Nepal, and Terms and Conditions of the agreement are yet to be discussed. This shows that while the arrangements of the agreement are there in writing, its real operation is yet to be seen. All such modalities and procedures were provisioned to be negotiated

22 This section is heavily based on the consultative meeting with former commerce secretaries and joint secretaries and officials at the department of customs of government of Nepal.

23 This section is heavily based on the consultative meeting with former commerce secretaries and joint secretaries and officials at the department of customs of government of Nepal.

through future bilateral consultative meetings and negotiations (between Nepal's Ministry of Commerce and China's Ministry of Transportation). However, these meetings were never held. Several bureaucrats and technocrats who were involved in the formulation and signing of the agreement have affirmed via consultative interviews that no further direction was provided from Nepal's Prime Minister's Office to further negotiate the agreement; leaving it in a disarray. With such inertia from the higher governing body, the ministry authorized with facilitating the agreement i.e. The Ministry of Industry, Commerce and Supplies was left in a limbo with regards to pursuing the agreement. Moreover, the limitations in part of ministerial and bureaucratic level in conducting negotiations for the activation of the agreement can be understood from three different aspects:

Frequent transfer of officials

The protocol to the agreement had stipulated for two technical committees to be formed at Secretarial and Joint Secretarial level to conduct negotiations and consultative meetings. A directive committee consisting of Commerce Secretary and a technical committee consisting of Joint Secretaries from the Ministry of Commerce were assigned with the task of furthering the agreement and negotiating the modalities and procedures. However, frequent changes in secretarial and joint secretarial positions (transfer decisions by the Prime Minister and the Cabinet) and officials at bilateral and regional division at the Ministry of Commerce has impeded the formulation and functionalization of any such committee. The frequent transfer of officials has been attributed to the cabinet – which makes officials transfers to meet their political agendas. Consultative interview with a bureaucrat revealed that the joint secretaries (who are involved in technical committees) are transferred within a few months of appointment (when they refuse to work according to cabinet decisions). This has disrupted any progress that could have been achieved by the technical committee.

Weak negotiation capacity

Consultative interview with a joint secretary at the Ministry of Commerce affirmed that the Chinese bureaucracy is vastly different from Nepal's bureaucracy. In China, any ministry is led by a minister who performs tasks and hold responsibilities as both – State Minister and Secretary i.e., at both political and administrative level. He/she represents the state in most bilateral negotiations. In contrast, in Nepal, the Secretary represents the state i.e., there is no active involvement of an incumbent minister in bilateral treaties and negotiations. This has weakened Nepal's negotiation and bargaining capacity in bilateral dialogues and meetings.

Lack of budgetary support for TTA

Consultative interviews with officials at the Ministry of Commerce has also revealed that the government has failed in allocating the necessary budget in activating the agreement. The agreement which came into effective from February 2020 was allotted budgetary support only in fiscal year 2020/21 to conduct pre-feasibility studies; showing that the past five years (since the signing of the agreement) has been a complete waste.

B4. Pre-existing barriers to trade with China

An empirical study into 'Current Macroeconomic and Financial Situation of Nepal' published by Nepal Rastra Bank (NRB) has revealed that Nepal's total trade volume with China stood at 12 percent (Nepal Rastra Bank, 2021) in fiscal year (FY) 2020/21. Out of the mentioned percentage, barely 1 percent to 2 percent (of the trade) took place via Kodari-Zhangmu and Rasuwagadhi-Kerung border points[24] with the remaining 11 to 12 percent taking place via Indian routes[25]. The Border Citizenship Card, provided to border residents within 30 kilometers of border point (Shneiderman, 2013) has led to a transportation syndicate along Kodari-Zhangmu border point which can be considered as one of the pre-existing barriers to trade with China. As per the provisions laid, only those trucks that are operated by border residents are allowed to go up to Khasa market (Zhangmu in China) to get Nepal bound goods. Considering this, border residents have been exploiting this special provision and have been hiking price for their transportation services; charging up to NPR 350,000 to NPR 400,000 to transport goods from Khasa to Kathmandu[26]. Comparing this to the normal and appropriate fare, the transportation cost (between Khasa to Kathmandu) is around NPR 30,000 to NPR 50,000. To stop this, several requests were made by the Government of Nepal to China to drop-off goods at Nepal's side of the border. This would have allowed traders to individually pick-up their cargo and consignment; yet this has not been materialized. Consequently, a cartel culture has developed on the pretext of providing employment to border residents which has created a deep transport syndicate; ultimately making it exorbitant for traders to trade with China via Kodari-Zhangmu border point.

Physical distance is another pre-existing barrier. The nearest Chinese port from Nepal is five times farther than the nearest Indian port from Nepal[27]. This

24 Department of Customs. (n.d.). Statistics. Ministry of Finance. https://www.customs.gov.np/page/statistics

25 ibid

26 This section is based on consultative interview with Nepali importers who import goods via China.

27 Nayak, N. R. (2018, September 27). Nepal-China Transit Agreement: An Evaluation | Manohar Parrikar Institute for Defence Studies and Analyses. Manohar Parrikar Institute for Defence Studies and Analyses. https://idsa.in/issuebrief/nepal-china-transit-agreement-nnayak-270918

exorbitantly increases the transportation cost for Nepali traders. Similarly, most of the goods that come to Nepal essentially comes through Lanzhou-Tibet-Xigaste-Tatopani/Rasuwa route; meaning goods coming from any four sea ports mandatorily has to come to Lanzhou and enter Nepal as there has been no development on the other promised routes. This has increased the cost of transporting goods via Chinese routes with no options of alternatives.

Geographical and infrastructural obstacles, in particular poor road conditions and longer time duration (ensuing higher cost), administrative hassles, compulsion of document disclosure, language barriers, time constraints, and lack of cross-border infrastructure like warehousing facilities, dry ports and yards have also been identified as the existing barriers in implementation of TTA. Apathetic towards complete implementation of agreed facilities has also made importers face non-tariff barriers in cargo operation across China. All these has failed in motivating Nepali traders to use routes under TTA, further pushing them to resort back to Indian ones[28].

A retired joint secretary from the Ministry of Commerce revealed that the promised railway development up to Kerung under China's 13th National Plan was an unattainable target. The geological situation to build a railway connectivity via Tibet to Nepal is not feasible. Railway cargo will have to pass through paths that go over 13,000 feet above sea level; requiring tunnels rather than mountain pass or hill roads. Most stakeholders were of the opinion that China wants to gain access to Indian and Bangladeshi markets from the railway network. Furthermore, this was also negotiated by the Chinese government while signing the TTA. Thus, one can assume that only when Nepal grants China access to India and Bangladesh, will they build the railway connecting Nepal to Kerung.

B5. Soft economic embargo along Nepal-China border

This section explores the reasons for the soft economic embargo along Nepal-China border, the volume of loss due to the embargo and the alternative routes that were used by importers due to the northern border blockade.

Fear of Covid-19

Fear of Covid-19 and weak infrastructural facilities have been identified as the major reason for the border closure at Tatopani and Rasuwa border points. Initially

28 This section is based on consultative interview with Nepali importers who import goods via China and are experts on Nepal-China trade.

the Nepal-China border point was shut by Nepali border security personnel due to increasing cases of Covid-19 in China. Chinese security personnel in response had urged the Nepali side to keep the border open. However, the request was not met positively. Gradually, with increasing cases in Nepal, the border closure was furthered by the Chinese side. According to officials at Tatopani and Rasuwa Customs Office – lack of strict Covid-19 regulations and protocols, weak sanitization and quarantine procedures adopted by traders and transporters (truck drivers) has led to the border closure. Moreover, neither Tatopani nor Khasa have good and manageable container traffic, due to which trucks and consignments are seldom disrupted. Similarly, these regions are also victims of frequent natural calamities including landslides, flooding and earthquake which completely shuts off the entire region for months; halting transit, trading, and local border-line activities.

Currently, only Chinese trucks are allowed to enter Nepal to drop off cargo consignments i.e., there is 'one-way cargo' in operation. Trucks and cargo are allowed to enter Nepal yet none Nepali origin trucks or cargo are allowed to enter China. Custom offices at Rasuwa and Tatopani are also following the 'hook-and-drop' method, where no human interface takes place. In this method, Chinese trucks enter Nepal and drop the consignment following which Nepali laborers and truck drivers pick up the delivery (dropped consignment) and bring it to the Customs Office. These individuals later go for their state-mandated quarantine requirements. The whole process is cumbersome and time consuming due to which only 5-6 Chinese trucks enter Nepal on a daily basis; ultimately making it easier and cheaper for Nepali traders and importers to import via southern/Indian routes.

Nepal-China trade figures and volume of loss

(This section has taken into consideration figures between two fiscal years, (FY) 2019/2020 and (FY) 2020/2021).

The soft economic embargo on Nepal's northern border region has resulted in immense loss at both regional and national level. During fiscal year (FY) 2020/2021, Nepal faced a drop in its import with China by 12.4 percent year-on-year[29]. Examining this empirically, Nepal's imports from China had increased by 40 million, from NPR 169.7 million in (FY) 2019/2020 to NPR 210.5 million

29 Prasain, K., & Ghimire, B. (2021, March 5). Importers turn to sea to escape vagaries of northern border. The Kathmandu Post. https://kathmandupost.com/money/2021/03/05/importers-turn-to-sea-to-escape-vagaries-of-northern-border

in (FY) 2020/2021. But exports had decreased by NPR 198 thousand, from NPR 1.13 million in (FY) 2019/2020 to 940 thousand in (FY) 2020/2021[30]. This increase in imports has been attributed to the continuous transfer of shipments/cargos to Indian ports by Nepali traders, i.e., import of Chinese origin goods sustained through Kolkata, Haldia and Vishakhapatnam ports of India.

At Rasuwa Customs Office, imports had reduced by NPR 11.23 million, from NPR 26.3 million in (FY) 2019/2020 to NPR 15.1 million in (FY) 2020/2021 and exports had reduced from NPR 583 thousand in (FY) 2019/2020 to reach nil in (FY) 2020/2021. Import share at Rasuwa had reduced to 1.3% in (FY) 2020/2021 (as compared to total share of imports across all other custom points) and export share had reduced by 0.66% in (FY) 2020/2021[31].

At Tatopani Customs Office, imports had reduced by NPR 2.9 million, from NPR 8.2 million in (FY) 2019/2020 to NPR 5.2 million in (FY) 2020/2021 and exports had reduced from NPR 137 thousand in (FY) 2019/2020 to reach nil in (FY) 2020/2021. Import share at Tatopani had reduced to 0.37% in (FY) 2020/2021 (as compared to total share of imports across all other custom points) and export share had reduced by 0.16% in (FY) 2020/2021[32]. Similarly, customs offices both (Rasuwa and Tatopani) managed to collect only NPR 2.38 billion (which was 17 percent of the targeted revenue that was to be collected) during (FY) 2020/21[33].

Examining on a more micro-level, local residents, traders, importers and businessmen faced huge losses due to border closure. With borders closed, most of them diverted their consignments to Southern borders/Indian ports. Normally goods imported from China (Tainjin to Lhasa to Tatopani) takes 10 to 15 days. While goods imported from India (Kolkata to Raxual to Birgunj) takes 40 to 45 days. This shows that Indian routes take longer than Chinese routes and that importing from India is essentially costlier than importing from China. However, given Nepal has higher volume of imports than exports; the

30 https://kathmandupost.com/money/2021/03/05/importers-turn-to-sea-to-escape-vagaries-of-northern-border
https://www.customs.gov.np/page/fts-fy-207778

31 ibid

32 ibid

33 Devkota, H. (2020, January 26). Rasuwa customs collects Rs 27.5 billion in revenue since 2015. My Republica. https://myrepublica.nagariknetwork.com/news/rasuwa-customs-collects-rs-27-5-billion-in-revenue-since-2015/

soft embargo compelled Nepali traders to import 70% of their goods via Indian routes (with higher freight charges). Moreover, due to the diversion, Nepali traders were also found to be paying NPR 1.2 million more per container to import goods from India routes[34].

B6. Government's Response and Action

This section explores the actions and responses undertaken by the governments of Nepal and China to solve the soft embargo alongside exploring the possibility of implementing the Transit Transport Agreement signed in 2016.

Lack of attention from both the governments

Government of Nepal's unresponsiveness on the soft embargo shows that Nepal is clearly dependent on India for all of its imports (65% of total imports). Not only imports, Nepal's exports are also highest with India (74% of total exports). Any disruption in trade via southern border points bring huge repercussions on Nepal's economy. Comparing this with China, Nepal's trade with China is minimal as compared to India. Goods that come to Nepal via northern border are light goods including clothes, shoes, toys among others; most of which fall outside basic necessities. The economy in large and the general public are not heavily impacted in situations when Nepal's trade with China gets disrupted. Considering this, there has not been much uproar among civilians, and also not much initiative from government as well regarding the border closure.

With regards to the Chinese government, it has been understood that China is not giving much importance to Nepal in its trading activities. China's trade with Nepal is almost negligible as compared to its trade with other countries, hence there has not been much efforts (from the Chinese government) to revive the border activities. Empirically speaking, China imported goods worth roughly NPR 720 thousand in fiscal year (FY) 2019/2020 from Nepal[35]. Comparing this value to its total imports of around USD 2,068,950 million shows how insignificant China's import balance is with Nepal[36].

Diplomatically, the inability of Nepali government to convince to their Chinese counterparts is also prolonging the closure in border trade. There are five

34 Prasain, K., & Ghimire, B. (2021, March 5). Importers turn to sea to escape vagaries of northern border. The Kathmandu Post. https://kathmandupost.com/money/2021/03/05/importers-turn-to-sea-to-escape-vagaries-of-northern-border

35 https://www.customs.gov.np/page/fts-fy-207778

36 World Integrated Trade Solution. (2019). China Trade Summary 2019 | WITS | Text. https://wits.worldbank.org/CountryProfile/en/Country/CHN/Year/LTST/Summarytext

Nepalese diplomatic missions (four consulates and one embassy) in China; the highest number of Nepalese missions as compared to any country. All of the consular services are located in areas of high transit and trading activities such as Lhasa, Chengdu, and Guangzhou. Weak and slow response of these consular in opening up of border closure also seems to be hindering the opening of transit and trade routes via China.

China's intention to trade via Kora La

With regards to the soft embargo at Tatopani border point, the research has found out that China is planning to make a strategic shift from Tatopani and Rasuwa to Nechung (Kora La, Mustang). Chinese authorities intend to stop operations from Tatopani-Khasa route and resume trading and transit operations via the Nechung-Lizi route. Nepal's northern border points have always been a matter of sensitive topic for China. Back in early 2000s, trade traffic from Tatopani-Khasa was shifted to Rasuwa-Kerung when Chinese security authorities found out that Tibetan refugees were using this route to gain entry into Nepal. Fast forward, post the 2015 earthquake, Tatopani was once again completely shut and Khasa market was relocated/shifted to Shigatse after Chinese rescue mission found manuscripts/teachings and prophecies of Dalai Lama in wrecked houses post the earthquake. Fear of any further increase in pro-Tibetan sentiments and activities along this region has irked Chinese authorities, making them reluctant to operate via this border point. Since 2015, China has allowed the Tatopani-Khasa route only for consignments, with no cross-border human traffic/movement.

Considering the past and the current Covid-19 situation, one can say that China is planning a long-term strategic shift in transferring trade and transit activities to Nechung-Lizi at Kora La, Mustang. Nechung-Lizi border point had previously halted carrying out import and export of goods in 2003 due to Chinese reluctance (in particular, the heavy traffic of religious leaders to India via this route and the after remains of the Khampa revolt)[37]. Moreover, transaction and trade of goods via this route has been granted by China under the TTA. The Chinese government has already built an international gateway on Lizi (China's side of the border). Nepal government too is preparing a detailed project report (DPR) to construct a dry port at Nechung (Nepal's side of the border). This suggests that both the government are aiming to commence transit services via Kora La and reducing the dependency/burden down along Tatopani-Khasa route in the upcoming years.

37 Koirala, B. (2015, December 5). Korala border point can be opened in three months. The Himalayan Times. https://thehimalayantimes.com/nepal/korala-border-point-can-opened-three-months

B7. China's strategy to shift Nepal-China border points for cross border trade

Nepal-China prime trade points Tatopani and Rasuwagadhi have been facing significant obstacles from Chinese side on its operationalization over the years. The Tatopani point is virtually closed following the earthquake in 2015. Regarding Rasuwagadhi point, the export from Nepal has been halted given the covid pandemic since 2020. Few goods containers are allowed from Rasuwagadhi point signaling the Chinese intention to gradually close the border point. China intends to operationalize Yari (Humla)-Purang and Nechung (Mustang)-Lizi for cross-border trade, making a strategic shift from Tatopani and Rasuwagadhi. However, the feasibility and practicality of operationalizing Yari (Humla) and Nechung (Mustang) points is questionable given the geographical constraints and availability of infrastructure.

Nepal's desire to diversify border points in the northern border

Nepal has long been negotiating with China to diversify the border point to facilitate the cross-border trade. Nepal signed 20-point agreement and both parties agreed to facilitate the opening of seven border points in Olangchungola, Kimathanka, Lamabagar, Gorkha Larke, Mustang, Mugu and Humla[38], all in diffilcult topographical terrains. Although the local unofficial trade activities are being carried out in these points, the formal operationalization is far from materialization. Earlier in 2012, Nepal and China already agreed to facilitate bilateral trade through Nechung (Korala) at Mustang.

In 2017, in a bilateral meeting, Chinese side proposed to make an on-site visit to five new proposed borders point out of total 13 new site proposed from Nepal's side. However, the five sites selected by China for further exploration and field study was never revealed[39]. In 2020, Nepal government initiated a full-fledged feasibility study to construct an inland clearance depot near to the Korala pass at Mustang, following the pre-feasibility study completed earlier[40]. However, the Chinese move to close the operationalization of Tatopani and Rashuwagadhi which remains the major trading points with already constructed dry ports, and open up Korala (Mustang) and Yari (Humla) points is more strategic rather than facilitating Nepal-China bilateral trade through diversification of border points.

38 Shrestha, B. N. (2015, November 29). Nepal-China Seven Border Crossing-points. Border Nepal Buddhi. https://bordernepal.wordpress.com/2015/11/29/nepal-china-seven-border-crossing-points/

39 Republica. (2017, September 21). Chinese side to make on-site visits to proposed more border points. My Republica. https://myrepublica.nagariknetwork.com/news/chinese-side-to-make-on-site-visits-to-proposed-more-border-points/

40 Xinhua. (2020, December 2). Nepal conducts feasibility study to develop dry port at border point - Xinhua | English.news.cn. Xinhuanet. http://www.xinhuanet.com/english/asiapacific/2020-12/02/c_139558835.htm

Movement of Tibetan refugee as perceived threat by China

Nepal's northern border has historically been subject to China's sensitivity regarding the movement of Tibetan refugees. Chinese reluctance towards using Tatopani and Rasuwagadhi border points relates to the instances of reported Tibetan refugees' entry to Nepal, coupled with the infrastructural damage caused during the 2015 earthquake, and the safety protocols introduced during Covid pandemic, which has virtually blocked the bilateral trade activities through these points. Since the Western border is comparatively more remote, a shift to Yari (Humla) and Nechung (Mustang) is likely to make cross-border trade less prone to be disturbed by Chinese concerns for Tibetan refugees.

Concerns on feasibility of trade through western border points

Owing to extreme geography and alleviation, the proposed border point at Mustang and Humla for bilateral trade lacks proper roads and infrastructural development. Although the present routes were built as access routes and not as trade routes, given their historical usage and significance to China's connection to the South Asian and Indian region, Tatopani and Rasuwa have the most infrastructure in the form of roads, ports and warehouses.

Yari (Humla) and Kora La (Mustang) are severely lacking the infrastructure for trade facilitation. The Yari (Humla) pass is closed and is not connected to any national highway. The required development for this route will take a very long time and as such is not expected to come into operation within few years. Kora La (Mustang) is comparatively ahead - the Chinese government has already built an international gateway on Lizi (China's side of the border) and Nepal is preparing a detailed project report (DPR) to construct a dry port at Nechung. Regardless, the shift of border points will assuredly be costly for Nepal since Yari (Humla) and Nechung (Mustang) lie at a much greater distance and alleviation from Kathmandu. Moreover, while Tatopani and Rasuwa provide linkage to the Lhasa market, the Western border points of Lhasa have a sparser settlement.

Prospects of bilateral trade through western borders

Shift to Yari (Humla) and Nechung (Mustang) can bring Nepal closer to the Central Asian market and relieve dependence on the barely-operational Tatopani and Rasuwagadhi points, but the severe need for development in road connectivity and internal linkages in Nepal leads to the conclusion that these trade routes will be costly and take decades to come into use.

C. ANALYSIS AND CONCLUSION

Withholding its transit and transport objectives, it has come to a conclusion that the agreement was signed to meet the political agendas of the then ruling government. Although the agreement was heavily triggered by the unofficial embargo and heavy agitations observed along the Nepal-India border in 2015, key findings and analysis drawn in this research summarizes that the historic agreement signed between Nepal and China was a tool used by the then KP Sharma Oli government to feed into their personal interest and make a mockery out of the general public through its ill intentional commitments. This can also be better understood from Nepal's political landscape. KP Sharma Oli back in 2015 (particularly during the border blockade) was lauded for his strong stance and resistance to the Indian establishments' tactical support towards the border blockade. Embargo over goods transit to Hills via Terai plains from India had fueled anger and nationalist surge across the country. Cashing on this opportunity, the Oli government of 2016 rose and came in to power on nationalistic sentiments, standing against India and promising the general public of a better transit and transport partner. Gradually, Oli turned North, visited China after winning the election and signed a number of agreements including TTA.

Oli's action back then can be understood as using the pro-China card to feed into his personal and party's interest. Putting it in simpler words, the government (back then) needed to deliver a strong political message to both India and the general public that Nepal could divert to Chinese routes in circumstances where India imposed another economic embargo. Keeping this in mind, the agreement and its subsequent protocol was formulated, negotiated and finalized with grandiose objectives and political fanfare. Soon the agreement and its implementation were scrapped off from national priority; leaving it as a political gimmick of the then government to meet its political interest and promises that it had made before winning the general election. As the agreement was discarded off the government's priority list, so was the various preliminary and feasibility studies (including the development of international transit gateway, customs offices, immigration offices, check-point post and four-lane road connectivity to border points). In a post-agreement meeting in 2019, China had agreed to conduct on-site evaluation while Nepal had agreed to take over environmental and legal clearances[41]. However, the meeting too was limited in political and diplomatic talks with no follow-up practical action.

41 Giri, A. (2021, July 11). Nepal's transit deal with China makes no headway even after five years. *The Kathmandu Post*. https://kathmandupost.com/national/2021/07/11/nepal-s-transit-deal-with-china-makes-no-headway-even-after-five-years

Nepal is buffer country between two giant neighbors with each of them having their own importance. In comparison with India, China is unpredictable in the matter of allocating points and allowing cargo movements. Covid-19 has also restricted the movement of cargo/consignments and unvaccinated people; a trivial concern that could be resolved with timely immunization and better bureaucratic negotiations. Unless the Nepali government undertakes sincerity to resolve the existing barriers encountered in bilateral trade; increasing more transit route will prove to be more of a burden than a boon.

Nepal being a landlocked/land-linked country, any alternate and additional trade route will unquestionably provide an edge in dealing with transit and transport negotiations. For any transit and trade agreement to be fruitful, intention and objective of the agreement needs to be brought in without any personal or vested interest of the incumbent government. The TTA fared very poorly in this regard as it failed to free Nepal's northern trade and transit routes from hindrances in relation to smooth operation of ports and cargo movement.

China, India and Bangladesh are touted to be the next booming global markets and are rapidly graduating into upper-class countries, with increasing consumption and income. Consequently, Nepal too could benefit greatly by growing in tandem with them. However, consultative interviews have concluded that only when Nepal grants China access to India and Bangladesh via its territory, the Trans-Himalayan Connectivity can be fully capitalized by Nepal. China would then build full-fledged railway line and services and other transit facilities, connecting Nepal to South Asia. This would make Nepal a transit-hub and transshipment-hub. However, the development of the multimodal connectivity seems to be in a dilemma. Nepal government is still hesitant in agreeing to the clauses under THMCN and TTA as it is unsure about whether Nepal or China would gain transit facilities from it. Similarly, investments for the infrastructural development between the two countries is yet to be negotiated. Nepal also lacks systematic store housing and supply chain management. Moreover, concerns have also risen as to whether Nepal can handle the movement of China bound trucks and rail cargo (via its territory to and fro South Asia) without impeding its own domestic trucks and cargo movement. All these has cast dilemma over the transit agreement, multimodal connectivity network and railway route; with only preparatory works being initiated.

E. RECOMMENDATIONS

This study recommends the following policy prescription for the better implementation of the Transit Transport Agreement alongside strengthening the bilateral transit and trade ties between Nepal and China.

1. Strengthen bilateral mechanism and understandings to ease cross-border trade and transportation on both local and national level.
2. Introduce modern custom rules and protocol to digitize custom protocols. Replace the current manual process to a more digitized one to ease trade via trade and transit points.
3. Increase surveillance via digitization of immigration offices to reduce cross-border crimes and illegal operations (including mobility, transaction and trade).
4. Develop consistency within the Special Citizenship Card provisions for border residents; allowing them to cross the Nepal-China border for cross-border engagements. Ensure their rights to livelihood and residency as secured by the Citizenship Card.
5. Establish clear modalities for project under the Belt and Road Initiative (BRI). Develop the Standard Operating Procedures (SOP), funding/ investment modalities and implementation modalities without compromising on Nepal's national interest.
6. Expand and modernize infrastructural connectivity to the northern border districts via North-South Corridor i.e. – Koshi, Gandaki and Karnali corridor.
7. Negotiate strongly for proper implementation of protocols under the Transit Transport Agreement (TTA) for Nepal's use of 4 Chinese sea ports and 3 Chinese dry/land ports.
8. Conduct timely bilateral meetings consisting of both contracting parties and competent authorities to resolve the problems encountered in the transit and transport operations.
9. Establish a 'Facilitative Body', consisting of stakeholders to short out and provide feedback to the concerned authority regarding transit and transport services.
10. Consult businessmen, traders, district-level officials, civil society members, academics and local border residents before bringing policies related to cross-border engagements.
11. Avoid future border blockades on transit points via stronger lobbying by bureaucracy and local governments and adoption of standard quarantining and health safety protocols along northern transit points.

12. Facilitate people-to-people engagement and relations by ensuring easy access to cross-border movements. Recognize the special cross-border relation of people living in the bordering districts before introducing any border management practice relating to cross-border mobility that directly impact peoples' livelihood.

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With the implementation of the new constitution and institutionalization of democracy, governments at various levels in Nepal are currently engaged in driving the agenda of prosperity. Nepal's interests in pursuing infrastructure development, connectivity and foreign direct investment have intersected with the strategic interests of great and emerging powers. Geopolitical competition at the international level between great and emerging powers as well as renewed hostilities between India and China has become an additional matter of concern for Nepal as it seeks to pursue development cooperation and projects of connectivity. Engaging in regional connectivity and development cooperation has implications for a country's strategic and security interests. Nepal needs to develop the capacity to balance its national and strategic interests while pursuing foreign policy, projects of regional connectivity, development cooperation, and foreign-direct investments. This issue of publication primarily engages in analyzing the various dynamics of foreign engagements at federal and provincial levels in Nepal, the interaction between geopolitics and Nepal's quest for infrastructure development, and recent trends in Nepal-China cross border relations.

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