

China's Emergence in Nepal's Infrastructure

STATUS, ISSUES AND CHALLENGES

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Preface

In the last few decades, overseas infrastructural engagement has become an important component of China's foreign policy. Chinese private and state-owned enterprises have increased their foothold in the global infrastructure landscape in a tremendous manner, becoming the world's largest contractors for infrastructure projects across the world. China's inherent motive to encourage its companies to invest abroad is driven by its ambition to expand the international market for its domestic firms as well as to realize larger strategic aims of expanding its economic and political influence. China's domination of infrastructure networks in developing countries has escalated remarkably after the announcement of the Belt and Road Initiative (BRI) in 2013.

Nepal became a signatory member of BRI, China's flagship foreign policy programme, in 2017. Although none of the projects under BRI has taken off in the country, Nepal has witnessed an increasing presence of Chinese companies and state-backed enterprises in the infrastructure sector. While China's engagements in Nepal's infrastructure are intended to address Nepal's infrastructure gaps, it is not uncommon to find Chinese engagement being driven by vested interests and collusion with Nepal's political elite, resulting in serious irregularities in contract awards, project management, infrastructure governance mechanisms, and violation of international integrity norms. Manipulation of the procurement process in critical infrastructure has allowed Chinese companies to advance their business interests in the country while allowing the Chinese state to expand its influence within Nepal's polity.

Although the nexus between the local agents of Chinese contractors and Nepali decision makers have occasionally been reported in the Nepali media, there is a lack of comprehensive research and analysis regarding infrastructure governance and how Nepal has engaged with Chinese companies and contractors. There is also scarce information regarding the extent of China's engagement in Nepali infrastructure. This report aims to fill these gaps with thorough investigation and analyses of malpractices in project procurement and implementation.

This report, perhaps the first of its kind to extensively document China's engagement in Nepal's infrastructure, is the outcome of a year-long research, during which period the researchers extensively interviewed a large number of stakeholders at the federal, provincial and local levels to understand various facets of China's emergence in Nepal's infrastructure sector. Key Informants included political actors, parliamentarians, former and serving bureaucrats, representatives and agents of Chinese companies, journalists, businesspersons involved with and connected to infrastructure projects, and analysts. Various literature on China's engagement in the infrastructure sector were thoroughly reviewed to identify the historical trend and current patterns to compare China's presence across South Asia. Data was derived from official government sources as far as possible.

The team organized several Focus Group Discussions (FGD) among relevant stakeholders at the federal level, and across various places in Nepal which have seen infrastructure projects either funded or contracted by the Chinese. Case studies of selective infrastructure involving Chinese contractors was one of the important aspects of the research. Case studies included in this report provide an in-depth insight into the irregularities in procurement, the nexus of corruption among politicians, bureaucrats, and Nepali agents of the Chinese contractors, and lack of infrastructure governance mechanisms, thereby leading to malpractices that reflect Nepal's poor response to corruption.

The first chapter of this report analyzes bilateral assistance in Nepal's infrastructure sector from a historical perspective. The analysis is divided into two timeframes. First, it analyzes the bilateral cooperation and geopolitics of foreign assistance up to 1990 i.e., before the restoration of multiparty democracy in Nepal. It then analyses bilateral assistance between 1990-2008, the period of civil war, political instability and transition to a republic.

The second chapter analyzes bilateral assistance and procurement of infrastructure projects after 2008, which marks the emergence of China in Nepal's infrastructure sector. Specifically focusing on case studies of selected projects, this chapter examines irregularities in project procurement and malpractices regarding project governance in projects involving Chinese contractors, while also tracing their extent and involvement in four crucial infrastructure sectors, namely roads and highways, aviation, hydropower, and telecommunications.

The third chapter analyses the various malpractices in infrastructure procurement in Nepal, focusing on the ambiguities in the procurement process in Nepal that leads to a nexus between politicians, bureaucrats and contractors.

The fourth chapter presents a comparative analysis of Chinese infrastructure engagement in Nepal vis-à-vis India and Japan, historically the two major bilateral partners in Nepal's infrastructure sector.

The fifth chapter compares patterns of Chinese engagement across South Asian countries vis-à-vis Nepal, focusing on Sri Lanka, Pakistan, and Bangladesh. It identifies similarities and differences in the patterns of Chinese engagement in infrastructure across these South Asian countries. This chapter also elaborates on China's strategic aim to rise as a regional hegemon through dominance of infrastructure across South Asia.

The last chapter concludes the report by summarizing the major findings and provides some recommendations based on the findings.

Abbreviations

ACCC	Aluminium Conductor Composite Core
ADB	Asian Development Bank
AMIS	Aid Management Information System
APECF	Asia Pacific Exchange and Cooperation Foundation
AVIC	Aviation Industry Corporation
BBDMIP	Bheri-Babai Diversion Multipurpose Irrigation Project
BGHP	Budhi Gandaki Hydroelectric Project
BoK	Bank of Kathmandu
BOOT	Build, Own, Operate and Transfer
BoQ	Bill of Quantity
BRI	Belt and Road Initiative
CAAN	Civil Aviation Authority of Nepal
CAMC	China Automobile Manufacturer Company
CCB	China Construction Bank
CCCE	China Construction Civil Engineering
CCP	Chinese Communist Party
CCPG	Central China Power Grid International Economic and Trade Co. Ltd.
CCSI	China Communications Services International Limited
CEEC GHCB	China Energy Engineering Group Guangxi Hydroelectric Construction Bureau
CENTO	Central Treaty Organization
CESIF	Center for Social Inclusion and Federalism
CGGC	China Gezhouba Group Corporation
CHEC	China Harbour Engineering Company
CHINCA	China International Contractors Association
CIAA	Commission for the Investigation of Abuse of Authority
CIDCA	China International Development Cooperation Agency
CITCC	China International Telecommunication Construction Corporation
CM Ports	China Merchants Ports Holdings Co. Ltd
CMC	Central Military Commission
CMC	Cooperativa Muratori e Cementisti di Ravenna
CMEC	China National Machinery and Equipment Import and Export Corporation
CNEEC	China National Electric Engineering Company
Covid-19	Coronavirus Disease 2019
CPEC	China Pakistan Economic Corridor
CQNEC	Chongqing New Century Electrical Co. Ltd.
CTGC	China Three Gorges Corporation Ltd
CTGIC	China Three Gorges International Corporation
CWE	China International Water and Electric Corp

CWEIC	CWE Investment Corporation
DAC	Development Assistance Committee
DC	Douglas Commercial
DoR	Department of Roads
DPA	Development Partnership Administration
DPR	Detailed Project Report
DSF	Debt Sustainability Framework
EDC	Electricity Development Center
eGP	Electronic Government Procurement
EIA	Environmental Impact Assessment
EIB	European Investment Bank
EPC	Engineering, Procurement and Construction
EPCF	Engineering, Procurement, Construction and Finance
EU	European Union
EUR	Euro
EXIM	Export Import
FCAN	Federation of Contractors' Associations of Nepal
FDI	Foreign Direct Investment
FEPEC	Fujian Electric Power Engineering Company
FGD	Focus Group Discussion
FLS	Final Location Survey
FWO	Frontier Works Organization
FY	Fiscal Year
G2G	Government to Government
GBIA	Gautam Buddha International Airport
GDP	Gross Domestic Product
GIS	Geographic Information System
GMR	Grandhi Mallikarjuna Rao
GoN	Government of Nepal
HEP	Hydro Electricity Project
HIF	Himalayan Infrastructure Fund
HIPG	Hambantota International Port Group
HMG	His Majesty's Government
IBN	Investment Board Nepal
ICB	International Competitive Bidding
ICP	Integrated Check Post
IDA	International Development Association
IFC	International Finance Corporation
IFI	International Financial Institution
IFR	Instrument Flight Rules

IL&FS	Infrastructure Leasing and Financial Services Ltd
ILS	Instrument Landing System
IMF	International Monetary Fund
INR	Indian Rupee
IP	Internet Protocol
ISB	International Sovereign Bond
IT	Information Technology
JBIC	Japan Bank for International Cooperation
JICA	Japan International Cooperation Agency
JV	Joint Venture
KEC	Kamani Engineering Corporation
KfW	Kreditanstalt für Wiederaufbau
KI	Key Informant
KII	Key Informant Interview
KM	Kilometre
KRCL	Konkan Railways Corporation
KV	Kilovolt
KW	Kilowatt
LCGEP	Least Cost Generation Expansion Plan
LDC	Least Developed Countries
LoC	Line of Control
LoI	Letter of Intent
LTTE	Liberation Tigers of Tamil Eelam
MA	Modern Ark
MCC	Millennium Challenge Corporation
MEA	Ministry of External Affairs
Mhz	Megahertz
MKI	Morrison Knudsen International Inc
MoF	Ministry of Finance
MoFA	Ministry of Foreign Affairs
MOFCOM	Ministry of Finance and Commerce
MoU	Memorandum of Understanding
MoWR	Ministry of Water Resources
MP	Member of Parliament
MVA	MegaVolt Amp
MW	Megawatt
NAC	Nepal Airlines Cooperation
NC	Nepali Congress
NCP	Nepal Communist Party
NDCL	Nepal Doorsanchar Company Limited

NDF	Nordic Development Fund
NEA	Nepal Electricity Authority
NHE	Nepal Hydro and Electric Ltd
NHPC	National Hydroelectric Power Corporation
NLSS	Nepal Living Standard Survey
NORAD	Norwegian Agency for Development Cooperation
NPC	National Planning Commission
NPR	Nepalese Rupee
NRC	Nepal Railway Company
NT	Nepal Telecom
NTA	Nepal Telecom Authority
NTPC	National Thermal Power Corporation
NVVN	NTPC Vidyut Vyapar Nigam
ODA	Official Development Assistance
OECD	Organization of Economic Cooperation and Development
OECF	Overseas Economic Cooperation Fund
OFDI	Outward Foreign Direct Investment
OPEC	Organization of the Petroleum Exporting Countries
PAC	Public Accounts Committee
PAWRC	Parliamentary Agriculture and Water Resources Committee
PIA	Pokhara International Airport
PLA	People's Liberation Army
PM	Prime Minister
PMO	Prime Minister's Office
PPA	Power Purchase Agreement
PPMO	Public Procurement Monitoring Office
PPRC	Public Procurement Review Committee
PQ	Pre-Qualification
PRC	People's Republic of China
PTI	Pakistan Tehreek: e: Insaaf
QTR	Qinghai Tibet Railway
QYEC	Qingyuan Engineering Consulting
RMB	Renminbi
RNAC	Royal Nepal Airlines Corporation
SA	Société Anonyme
SAARC	South Asian Association for Regional Cooperation
SAIS-CARI	School of Advanced International Studies-China Africa Research Initiative
SAPDC	SJVN Arun III Power Development Company
SCIG	Sichuan Transportation Investment Group

SDLQ	Shandong Luqiqo Group
SDP	Small Development Projects
SEATO	Southeast Asia Treaty Organization
SIDA	Swedish International Development Cooperation Agency
SJVN	Satluj Jal Vidyut Nigam
SLA	Subsidiary Loan Agreement
SLPA	Sri Lanka Ports Authority
SMDMP	Sunkoshi Marin Diversion Multipurpose Project
SMEC	Snowy Mountains Engineering Corporation
SOE	State Owned Enterprise
SOT	Supply, Operate, Transfer
SPV	Special Purpose Vehicle
SR	Storage Reservoir
STOL	Short Takeoff and Landing
STWI	Seven Trent Water International
TAR	Tibetan Autonomous Region
TBEA	Tebian Electric Apparatus
TBM	Tunnel Boring Machine
TIA	Tribhuvan International Airport
UK	United Kingdom
UML	Unified Marxist–Leninist
UN	United Nations
UNDP	United Nations Development Programme
US	United States
USAID	United States Agency for International Development
USD	United States Dollars
USOM	United States Operation Mission
USSR	Union of Soviet Socialist Republics
UTHL	Upper Tamakoshi Hydropower Limited
VFR	Visual Flight Rules
WAPDA	Water and Power Development Authority
WB	World Bank
WSHPL	West Seti Hydropower Company Limited
Y-12	Yùn-12
ZTE	Zhong Xing Telecommunication
4G	4th Generation
5G	5th Generation

Executive Summary

This report focuses on China's historical and contemporary engagement in infrastructure in Nepal against the backdrop of Nepal's governance structures around infrastructure procurement and implementation. It also analyses other bilateral partners' engagement in infrastructure in the country and presents comparative analysis on China's infrastructure engagements in Nepal with other countries in South Asia. The report posits that while Nepal suffers from an infrastructure deficit to meet its development goals and fulfil its agenda of prosperity, for which bilateral and multilateral assistance and investment is crucial, current governance structures must be reformed to address the shortcomings that have resulted in poor procurement laws, cost and time overruns, poor quality infrastructure, and inadequate transparency and accountability in the project procurement and implementation process.

There has been intense focus on China's engagements, particularly in the infrastructure sector in developing countries across the world, both through its signature Belt and Road Initiative and other bilateral mechanisms. Chinese companies have increasingly invested in several countries of the developing world and participated in international infrastructure contracts in the 21st century. A similar pattern can be witnessed in Nepal in the last two decades, where Chinese infrastructure engagements have been scrutinized given the heightened geopolitical tensions between Nepal's two neighbours and the global US-China contest, and China's links with Nepal's political Left.

China has been one of Nepal's oldest bilateral partners, and remains the fourth-largest bilateral donor to Nepal with USD 380.45 million in disbursements (grants and loans combined) between the years 2017-2021. This is low compared to China's investments in the rest of South Asian countries. China has engaged in Nepal's infrastructure sector since the beginning of its foreign assistance programme in Nepal, with the historic Lhasa-Kathmandu Highway and the Prithvi Highway being landmarks. China's aid programme in Nepal has also historically been viewed and perceived from the lens of India-China geopolitical rivalry, as seen in both the Lhasa-Kathmandu Highway and the East-West Highway.

In Nepal, Chinese assistance and investments have steadily grown since 2008, when the country became a republic. Chinese assistance to Nepal should also be viewed in the context of Nepal's relations with India, particularly after the economic blockade imposed by India in 2015. China has provided both vocal and material support to Nepal during these periods and has engaged closely with Nepali security agencies on issues related to Tibetan exiles.

China's engagement in Nepal's infrastructure projects has been driven by both political motives and commercial interests. The establishment of the Chinese International Development Cooperation Agency (CIDCA) in 2018 further institutionalized Chinese aid in Nepal. Chinese influence among Nepal's Communist parties has been a key driver of Chinese interest in infrastructure projects, particularly where interests of both parties intersect. Chinese infrastructure development in districts bordering Tibet Autonomous Region (TAR), such as Rasuwa and Sindhupalchowk, suggests a strategic objective of securing the Tibetan frontier.

Chinese companies have been involved in diverse projects in Nepal, and China has also provided loans for infrastructure development. Chinese companies have also been involved in several infrastructure projects financed by other institutions. Chinese companies have also been at the receiving end of Nepal's domestic political swings, as seen in the Budhi Gandaki Hydropower project, which was initially awarded to China's Gezhouba Group Co. Ltd without a tender in 2017. However, under Sher Bahadur Deuba's prime ministership, the contract was cancelled due to transparency concerns. It was once again given back to Gezhouba when K.P. Oli took office, but the subsequent government headed by Deuba once again scrapped the agreement.

China and/or its companies have also introduced the Engineering, Procurement, and Construction (EPC) model in Nepal, with the Pokhara International Airport (PIA) built by China CAMC Engineering under this model, and financed by a USD 216 million China EXIM Bank loan. The awarding of the contract to CAMC was controversial, with questions raised over the contract awarding process as well as the design and construction of the airport itself. Although the airport was inaugurated in January 2023, the airport is yet to see any scheduled international flights. The Chinese Embassy in Nepal also claimed the PIA to be a flagship project under China's Belt and Road Initiative (BRI), which was controversial.

Contracts awarded to Chinese companies in other infrastructure projects have been scrutinised for the procurement process, transparency issues with the allegations of corruption, and delays in execution. Nonetheless, Chinese contractors have played a significant role in Nepal's infrastructure sector since 2008, in line with China's growing political influence as well as economic clout, allowing contractors to secure projects by being the lowest bidder. Some Chinese companies have also been blacklisted both by Nepali and multilateral authorities for shoddy performance.

Initially, India played a crucial role in Nepal's infrastructure development by extending assistance in major infrastructure projects like the Tribhuvan Highway, Tribhuvan International Airport, and several hydropower plants in the 1950s and 1960s. However,

the political relationship between Nepal and India has influenced the perception and implementation of Indian infrastructure assistance. The 2015 blockade strained bilateral ties, but India has continued to promote regional connectivity by initiating new infrastructure projects in various sectors. Under Prime Minister Narendra Modi's assertive foreign policy, India has expressed concerns about China's increasing engagements in Nepal's political and infrastructure spheres and decided to block market access to Chinese companies and contractors via Nepal, especially on hydropower sector.

As with other bilateral partners, China's engagement in Nepali infrastructure is associated with conditionalities, the primary conditionality being a preference for Chinese companies to pick up contracts and implement the project. A notable factor for the heightened Chinese engagement in Nepali infrastructure has been the close political links that have developed between the Nepali Left parties and China after 2008. Close political links have resulted in opaque EPC contracts that have been questioned by Nepali officials and institutions. Close links between the two sides have also resulted in Chinese companies awarding subcontracts to Nepali contractors affiliated with political leaders in a multilateral-funded project such as the Gautam Buddha International Airport, contrary to Nepal's project procurement norms. The close political links between the Nepali Left and China is also suggested by the fact that almost all big infrastructure projects since 2008 have been contracted to Chinese companies while the government in Nepal is headed by leaders of the Left.

The increasing links between the two countries on the political front has also resulted in other Nepali institutions awarding controversial contracts to Chinese companies, such as the Nepal Army in the Kathmandu-Terai Fast Track Road Project. The case of Nepal Airlines' acquiring Chinese aircraft is another instance where the purchase of the aircraft went ahead despite operational and other issues, and has resulted in severe losses for the national carrier. A similar preference was also seen in the first phase of the Kathmandu Ring Road expansion, executed by China as part of grant assistance, but whose designs were not overseen by the Nepali authorities. Chinese companies have emerged as the lowest bidders with the most extensive capacity and technical skills in government telecommunications infrastructure, as in the rest of the world.

While economic crises in Sri Lanka and Pakistan shone a global spotlight and concerns on Chinese lending practices, there are fundamental differences in infrastructure goals between Nepal and the rest of South Asia. Although weak state institutions, corruption, lack of transparency and accountability are common to the countries, Nepal's external debt exposure and its repayment ability are not yet under doubt. China's engagement in South Asian infrastructure landscape is ever increasing, but the driving factors behind such engagement are different between Nepal and the other South Asian countries.

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CHAPTER I

Bilateral Assistance in Infrastructure in Nepal: A Historical Overview

Summary

Nepal's infrastructure landscape has witnessed several paradigm shifts since the inflow of foreign aid and assistance in 1950s. Initially, smaller hydropower projects and highways were constructed by India, while China and the USSR also contributed to infrastructure projects in this period. The completion of the Tribhuvan Highway in 1955 with Indian assistance introduced Nepal's reliance on foreign aid for infrastructure projects. Recognizing the limited availability of resources, the first five-year plan acknowledged the need for foreign aid to ensure development.

Nepal received Indian aid to construct its first permanent airfield in Kathmandu and other airfields outside the capital. The 1960s witnessed a boost in Nepal's road development ambitions as a result of shifting geopolitical dynamics. China initiated the construction of the challenging Lhasa-Kathmandu Highway in 1961, also expanding its political influence in Nepal. This project was completed in 1967 with Chinese assistance. King Mahendra initiated the ambitious East-West Highway, with sections financed and built by various countries including the USSR, the UK, and the US, but predominantly India. Both these projects witnessed the impact of souring India-China relations, with Chinese aid and assistance seeking to minimize India's influence on Nepal.

In the 1970s, Nepal began seeking loan assistance from institutions such as the World Bank, Kuwait Fund, OPEC Fund, and UNDP to finance larger hydropower projects. A notable milestone in Nepal's hydropower development was the commissioning of the 60 MW Kulekhani I reservoir project in 1982,

which was financed by multiple institutions. Similarly, the establishment of the Nepal Telecommunications Corporation (NTC) as a state-owned enterprise in 1975, followed by subsequent reforms and the establishment of the Nepal Telecommunications Authority in 1998, marked significant progress in the telecommunication sector.

Foreign aid continued to play a pivotal role in Nepal's infrastructure development, with diverse countries and institutions providing assistance even during the Cold War. However, the effectiveness of aid varied, and Nepal's capacity to administer and manage development programmes remained another cause for concern. The allocation of aid was also influenced by geopolitical factors and Nepal's internal political landscape. Notably, the imposition of the autocratic Panchayat system diverted aid and projects towards politically expedient areas.

By 1990, Nepal had experienced over three decades of Panchayat rule. After the first Jana Andolan and re-introduction of multiparty democratic politics, reforms were introduced in the early 1990s that emphasized private sector participation, privatization of state-owned enterprises, and macroeconomic structural changes. However, political events such as the royal massacre and the Maoist civil war resulted in increased defence and military expenditure, hindering development and infrastructure spending. The state also faced challenges in maintaining administrative control in conflict-affected areas, leading to a decline in development spending. Furthermore, failed infrastructure projects such as the Arun III hydropower project and the signed in 1996 with India, faced criticisms and controversies involving politicians, activists, and civil society organizations. Controversies surrounding projects such as the Kaligandaki A Hydropower Project and the Melamchi Drinking Water Project also raised concerns about transparency and accountability of successive governments in handling foreign aid and infrastructure governance.

Overview of bilateral assistance up to 1990

Until the 1950s, infrastructure development was minimal in Nepal. Closed off to foreign visitors and reeling under the Rana dynasty's autocratic rule, infrastructure development was primarily concentrated inside Kathmandu valley, and in a few scattered areas in the Terai plains. Nepal's rivers were used to transport goods to India, primarily timber, which was supplied in great quantities to British-ruled India for railway sleepers, railroad ties,

bridge planks or home use. The development of railways on the Indian side, however, reduced the importance of such waterways for transport of timber. Railway lines on the Indian side of Nepalgunj, a Nepali border town in the west, opened up in 1885, while another line connected Forbesganj in eastern Bihar, adjoining Rangeli, in 1890. However, the primary railhead was Raxaul, the terminus of the Sugauli-Raxaul branch railway, which was connected by rail in 1898. “Thanks to those railroad connections, it now became possible to transport Nepal’s exports by boat or ox-cart up to the nearest Indian railroad terminus and then by railroad to different destinations in India”, wrote historian M.C. Regmi in *An Economic History of Nepal (1846-1901)*¹.

The impetus for developing a railway network inside Nepal began in the mid-1920s. The first passenger railway inside Nepal, between Amlekhganj and Raxaul began in 1927, while the currently operational Janakpur-Jaynagar line began in 1937. As early as 1965, a World Bank (WB) report recommended building a railway network in the plains for trade. The report recommended Nepal should develop three cross-border railway terminals in Nepalganj, Biratnagar and Birgunj². However, Nepal prioritised the development of roads inside the country due to limited resources, as stated by former Nepal Rastra Bank governor Yadav Prasad Pant in 1962: ‘In view of the country’s limited resources in the years to come, it would be necessary to concentrate on one mode of transport. For topographical reasons, development of roads will be most suitable for Nepal.’³

Bilateral cooperation in road infrastructure

Foot trails had dominated Nepal’s landscape until 1950, with a few stretches of roads built inside Kathmandu valley for use by the aristocratic class. Luxury cars were brought inside the valley by porters who carried them over the hills into the valley. However, the first extensive road network – one that connected Kathmandu to Hetauda in the plains and was named Tribhuvan Highway – was built with Indian assistance and completed in 1955. Construction of the highway began in 1953 at an estimated cost of USD1.92 million⁴, which was offered to Nepal as a loan package. Beyond expanding Nepal’s trade with India, the road was also strategically important from the Indian perspective, which had only three years previously lent its political weight behind the introduction of democracy and the return of the Shah king Tribhuvan to Nepal, which resulted in the end of the Rana dynasty’s autocracy. The highway construction was noted for little participation from the Nepali side except for unskilled labour, while India continued to administer and maintain the highway for seven years after its completion⁵.

From its very inception, bilateral and multilateral assistance has been vital to infrastructure development inside Nepal. The first five-year plan, introduced in 1956, said it would ‘rely heavily upon foreign aid’ due to limited resources, as to rely wholly upon external aid

would not only be damaging to our national self-interest and our capacity to manage our own affairs; it would also be futile, for in the absence of a strong effort on our part, that aid would soon dry up.’⁶ Transportation and power sectors were prioritised within infrastructure, and it was estimated that at least 71 percent of the plan would be funded by foreign assistance.

Further bilateral transport infrastructure aid projects continued to be conceived and executed in the decades to come. In 1958, the United States (US), India and Nepal jointly formed a Regional Transport Organisation to build almost 901 miles or 1,440 kms of roads within five years. However, ‘the organisation’s target was completely out of the realm of possibilities’, and as such, the project was abandoned in 1962 after constructing ‘148 miles of jeep track... paved 24 miles of existing road, graded 193 miles, and laid gravel on 41 miles’⁷. The project also left behind nearly United States Dollar (USD) 1 million worth of heavy construction equipment, which was, to United States Agency for International Development (USAID)’s chagrin, used on the historic Lhasa-Kathmandu Highway built by the Chinese, ‘a project United States Operations Mission (USOM) had no desire to support’⁸.

In the 1960s, with a shifting geopolitical scenario exacerbated by war between India and China and an internal political shift marked by King Mahendra’s imposition of the Panchayat system, Nepal’s road development ambitions began to grow. China began to expand upon its political and economic influence inside Nepal by initiating the construction of the Lhasa-Kathmandu Highway in 1961. The 112 kilometre (km) long highway, which was to follow the traditional trans-Himalayan trade route, posed significant engineering challenges and was estimated to cost USD 9.8 million. It was built by Chinese engineers and technicians, and completed in 1967. King Mahendra also initiated the ambitious 1,027 km long East-West Highway in the late 1950s and early 1960s. Initial surveys were conducted by Soviet engineers in 1959, who eventually built a 109-km section of the highway between Dhalkebar and Pathlaiya. The highway was initially regarded as ‘not economically justified’ by USAID, who refused to fund the estimated USD 70 million project⁹. Further, when China offered to finance and build a 100-mile stretch of the highway in 1964, ‘the King was impelled by pressure from New Delhi to turn over the project to the Indian government.’¹⁰ Eventually, the highway was completed in 2000, with India funding and/or constructing a majority of the sections, while aid programmes from the Union of Soviet Socialist Republics (USSR), the United Kingdom (UK) and the US (via an Asian Development Bank-funded programme) were vital for the other sections.

The pace of road construction increased by the mid-1960s, with both India and China agreeing to fund and build highways connecting Pokhara respectively. The 180-km-long Siddhartha Highway, which was agreed upon in 1964, connected Pokhara to Bhairahawa,

near the Indian border and was built by India. The highway was completed in 1971. Similarly, China signed an agreement to finance and build a highway connecting Pokhara to Naubise, near Kathmandu, in 1965. The highway was completed in 1974¹¹.

China also agreed to build a Ring Road around the Kathmandu valley in 1973 at a cost of USD 4.95 million, which was completed in 1977. A further agreement to build a highway connecting Pokhara to Surkhet was signed with China in 1975, but saw no progress. However, China contributed almost 80 percent of the funds towards the Pokhara-Baglung highway between 1988-1994, now named as Bhupi Sherchan Highway¹².

By 1989, Nepal's total road network had increased to 7,007 km from a paltry 276 km in 1951, with highways making up 2,087 km of the road network. Most of the highways had been built with bilateral assistance, although Nepal's foreign policy dictum of maintaining a balance between its neighbours meant such concerns also had their impact on bilateral assistance. To that end, as commentators have noted, Chinese assistance was primarily centred in the hilly and mountainous regions of Nepal, while Indian assistance was centred in the Terai plains¹³. Nepal's two neighbours have heavily invested in infrastructure in the country, with at least 84 percent of Indian and 65 percent of Chinese assistance being targeted towards the construction of 'roads, irrigation plants, airports, power and water supply systems'¹⁴.

Bilateral cooperation in hydropower development

Nepal had an early start to hydropower development, with the first hydropower plant set up in 1911 only 29 years after the first hydropower plant was built in 1882 in the US¹⁵. The 500 KW Pharping plant was set up by Rana prime minister Chandra Shamsher to bring electricity to the homes of the ruling class, with the equipment being provided through a grant by the British government. However, hydropower development faltered thereafter, despite an estimated theoretical power generation potential of 83,000 Megawatt (MW), and an economically feasible potential of 43,000 MW. A second plant was only established in 1936 at Sundarjal, north of Kathmandu. At the advent of democracy in 1951, Nepal generated only 1 MW of power from hydropower units¹⁶.

After 1950, Nepal began to seek bilateral assistance to realize its hydropower potential¹⁷. Projects were built under both grant assistance and through loan mechanisms. The first set of projects after 1950 were smaller in scale, and were built by India. The 1 MW Fewa Lake project and the 21 MW Trishuli project were both commissioned in 1967, while a 15 MW Gandak hydropower emerged as part of the Gandak Agreement signed between the two countries in 1959¹⁸. China built the 10 MW Sunkoshi run-of-the-river plant in 1972 as a part of its grant assistance. The USSR also financed a 2.4 MW project in Panauti in 1965.

Subsequently, coming into the 1970s, Nepal began to seek loan assistance to finance bigger scale projects. Multiple institutions such as the World Bank, The Kuwait Fund, Organization of the Petroleum Exporting Countries (OPEC) Fund, the United Nations Development Programme (UNDP), the Overseas Economic Co-operation Fund (OECF) of Japan and the Government of Nepal (GoN) all financed the 60 MW Kulekhani I reservoir project, the first of its kind in Nepal, which was commissioned in 1982. The project was financed under both loan mechanisms and as grant assistance, with differing repayment terms and period of loans, and total project cost was USD 117.8 million¹⁹. The 32 MW Kulekhani II project, a cascade project of Kulekhani I, was commissioned in 1986 and built with Japanese assistance at a cost of NRs. 124 million²⁰. The 69 MW Marsyangdi project was commissioned in 1989 at a cost of USD 244 million, with funding assistance from the World Bank, the German Kreditanstalt für Wiederaufbau (KfW) Development Bank, the Kuwait Fund for Arab Economic Development, the Saudi Fund for Development, the ADB and GoN²¹. Power generation costs for this project were significantly high at USD 3,600 per Kilowatt (KW)²².

Thereafter, structural adjustment programmes from the World Bank and the International Monetary Fund (IMF) ‘drastically changed the modality of hydropower financing’, with economic reforms intended to raise investments from the market²³. ‘In that vein, with contributions from International Financial Institution (IFI)s, the US invested in Bhotekosi (45 MW), and Norway helped to finance Khimti (60 MW). Not only did the US and Norway provide financing but also technical assistance²⁴.

Bilateral cooperation in aviation sector

Indian aid was vital in constructing Nepal’s first permanent airfield at Gauchar in Kathmandu under the same loan assistance programme as the Tribhuvan highway. Construction of the Kathmandu airport began in 1953 at an estimated cost of USD 147,000, but the runway was only long enough for smaller aircraft such as Dakotas which flew to nearby Indian cities such as Delhi, Calcutta and Patna, while larger aircraft from beyond could not use the runway, whose expansion could only be carried out in the 1960s by the US²⁵. As with the Tribhuvan Highway, it was noted that Indians continued to administer and maintain the airport seven years after it was completed. Between 1952 and 1963, five other airfields in Pokhara, Simra, Biratnagar, Bhairahawa, and Janakpur were also built with Indian assistance²⁶.

In the 1960s, the USAID programme shifted its transport infrastructure priorities from road-building to internal air transport systems. As USAID noted, ‘Road construction in Nepal had proven to be difficult, time-consuming and enormously expensive. Aviation assistance was now viewed as “the most efficient, rapid, economical and effective means”

of improving internal transport', and it initiated the Aviation Development Project and the Airport Development Project in 1959²⁷.

The US financed runway expansion at the Kathmandu airport to 2,013 meters, and in 1961, provided three Douglas Commercial (DC)-3 and two Short Takeoff and Landing (STOL) Pilatus Porter aircraft to the newly set-up Royal Nepal Airlines Corporation (RNAC). Between 1959-1974, the US invested over USD 8 million in communication and navigation equipments to the Kathmandu airport and six other airfields, 'financed improvements of nine existing airfields, funded training of RNAC officials and operators and the construction of airfield buildings, including six terminals and three buildings at the main Kathmandu airport,' and also funded surveys for 36 STOL airfields and built several of them²⁸.

Subsequently, between the 1970s and 1990s, ADB financed an expansion and upgradation of Tribhuvan International Airport (TIA) in Kathmandu under a USD 29.25 million loan. The project, which experienced significant delays, was finally completed in 1996, nearly 14 years after its target completion date²⁹.

Bilateral cooperation in telecommunications

Telephones arrived in Nepal 40 years after its invention, with a telephone system connecting Birgunj to Kathmandu being set up in 1915-16 by Rana prime minister Chandra Shamsher for private communications. It took another two decades before the system was upgraded to be used for 'administration, commerce and diplomacy'³⁰. In 1950, however, the infrastructure was 'practically non-existent'³¹. In 1959, a Nepal-India Telecommunications project began as part of the same tripartite agreement between the two countries and the US, with USAID contributing USD 2.9 million to install a 1,000-line telephone system in Kathmandu. International facilities were routed through Delhi and Calcutta, while India provided housing facilities for US-provided transceivers. Subsequently, US assistance was also vital towards establishing an internal radio communications network made up of 57 stations, with seven area stations, 'each with five to nine satellites... A remote-control receiver and building were erected in Kathmandu, and over 100 operators and maintenance personnel were trained'³².

A telecommunications department was set up in 1959, and renamed to the Telecommunications Development Board in 1969. Nepal Telecommunications Corporation (NTC) was formally established as a state-owned enterprise in 1975 after the Communications Corporation Act was implemented in 1971. The enterprise was incorporated under the Companies Act in 2004 as Nepal Doorsanchar Company Limited (NDCL), overseen by the Nepal Telecommunications Authority, which was established as a regulatory authority in 1998³³.

Donors' motivations for engagement between 1950 to 1990

When Nepal opened up to the world in 1950, it had almost no physical infrastructure. Infrastructure development was motivated to serve the ruling class. When Nepal's modernization journey began in 1950, foreign aid was seen to be critical in aiding Nepal's quest for critical infrastructure. Nepal is a unique case in that despite being a small country sandwiched by two large and populous nations, it received foreign assistance from diverse countries and institutions even during the Cold War, when ideological affinity affected donor motivation and foreign assistance practices. Whether such aid was effective enough to deliver its goals is a different matter, Nepal's ability to absorb and administer such development programmes was still in a nascent state.

From the donors' perspective, aid to lesser-developed countries such as Nepal allowed them to influence recipient countries. This was especially important in the post Second World War, when ideological differences between the US-led Western nations and the Soviet bloc and China, led to aid being directed by greater geopolitical motives. Donor countries could be said to be motivated by their strategic interests in recipient countries – such as the Lhasa-Kathmandu highway which also intended to serve as an alternative route for imports into Tibet at a time when India had prohibited all trade with China. The efficacy of aid is a function of the recipient country, and can often have limited utility. As Mihaly noted in his landmark study of foreign aid in Nepal up to 1965, 'in a nation that is politically and otherwise unprepared for change, and therefore for economic development, economic aid is an instrument of extremely limited utility. Aid can be politically effective, but only in those few instances where its efficacy is not dependent on the attainment of economic goals. An offer of aid can appear to manifest the donor's political support for the recipient – as did the Chinese cash grant to Nepal in 1956. And a facility financed by aid can be of strategic value to the donor – as are the Indian- and Chinese-built roads in Nepal.'³⁴

Despite the arguments surrounding the efficacy of aid, during the four decades between 1950-1990, Nepal received aid from several countries, including under programmes that seemed to overcome Cold War-era discomfort between donors, such as the US-India road building programme (it is another matter that the programme was ultimately deemed a failure). Unofficial estimates suggest Nepal received 85,000 million Nepali Rupees (NPR) as foreign assistance – including bilateral and multilateral sources – between 1951 and 1990³⁵. Nepal's first five-year plan (1956-61) expenditure of NPR 383 million was fully funded by bilateral sources, and although the proportion of foreign aid in subsequent five-year plans declined, the absolute volume rose at the rate of 21.6 percent between 1975-1990. By the end of this period, assistance from multilateral institutions expanded significantly, with multilateral assistance making up nearly 60 percent of the annual foreign aid disbursement to Nepal in 1990-91³⁶.

Aid received by Nepal also underwent significant shifts in donors' approach and interest areas, as seen by the US' withdrawal from road infrastructure in the 1960s and a shift towards governance, agriculture, health services and malaria eradication, and grassroots development from thereon. One of the reasons for this was also the imposition of the autocratic Panchayat system by King Mahendra, which resulted in aid and projects being diverted towards politically expedient areas. 'With USAID withdrawal of funds for panchayat grants and increasing domination of the Panchayat system, USAID reduced administrative support for the [Panchayat Development] program and lost interest in the ineffective policy dialogue with HMG'³⁷.

Although the US remained Nepal's largest donor until the mid-1960s, its rapprochement with Communist China in the late 1960s and its continued involvement in the Vietnam War resulted in the US viewing Nepal as inessential in its global contest against the Soviet regime. 'Washington's relative contribution declined from 40% of Nepal's total aid during 1962-65 to 23% during 1970-75, and further to about 12% during 1976-85'³⁸.

While instances of outright corruption under the Panchayat regime are harder to trace, the government of the day was regularly assaulted by charges of corruption³⁹. The Panchayat was described as a regime that was an instrument of 'compliance through coercion', and regularly disrupted either by government changes under the monarchy's direction or the anti-Panchayat movement spearheaded by the Nepali Congress⁴⁰. However, what is clear is that Nepal's internal revenue sources were not sufficient to meet its development targets. For example, in 1961, Nepal's internal revenue was USD 12.3 million; however, its regular budget expenditure was USD 14.1 million, while its development expenditure was USD 9.9 million⁴¹. This shortfall in meeting budgetary targets meant Nepal had to continuously rely on foreign assistance as a way to meet its infrastructure goals. Further, aid reliance did not contribute towards Nepal's economic growth during the Panchayat years, with Nepal's Gross Domestic Product (GDP) growth between 1965-89 averaging only 0.6 percent⁴².

Bilateral infrastructure gains during the 1950-1990 period can then be described as laying the foundations for Nepal's trajectory of infrastructure development. While domestic demand and policymaking through five-year plans outlined a vision for infrastructure, much of the bilateral assistance, especially in the grant assistance-led projects, can be seen in the light of great power contest for influence building in Nepal. The contributions of Nepal's two neighbours exemplify this fact.

The politics of aid in Nepal vis-à-vis India-China relations

When B.P. Koirala, the first elected prime minister of Nepal, visited China in March 1960, Zhou Enlai, then premier of China, told Koirala Chinese aid did not match the Indian aid

amount because ‘That may not be good for you or for us . . . India may become wary if we give you too much assistance . . . the international community would take it that we are trying to compete with India’⁴³.

With the India-China border dispute leading the two countries to war, China would revise such a thinking within a year. In 1961, after King Mahendra took over the government, China would offer to build the Lhasa-Kathmandu highway gratis. Chinese assistance was also pointed in its goal of reducing Indian influence within the then-kingdom, such as constructing the Narayangarh-Mugling highway in 1982 as an alternative highway to Kathmandu than the Indian-built Tribhuvan Highway. Chinese aid was also perceived as being attached with fewer strings, and was rendered ‘with great fanfare’, making grant conditionalities as attractive as possible, ‘without regard to what this might do to the economic utility of the aid’⁴⁴. For example, Chinese technicians employed on projects would be paid by China, but ‘not out of the grant’⁴⁵.

As noted above, the India-China rivalry also found expression in foreign assistance projects in Nepal, best seen in the case of the East-West Highway. The 1962 war, and the subsequent agreement over the Lhasa-Kathmandu highway, resulted in India’s deep suspicions over China’s intentions from the highway, expressed by its then prime minister Jawaharlal Nehru who said, “We did not like it... We pointed this out to the Nepal government... [but] We cannot order them about in this matter”⁴⁶.

India’s close political affinity with Nepal, which was derived out of the 1950 agreement between the two countries, resulted in Delhi’s close watch over Kathmandu and its decisions. Such affinity was the result of India’s outright role in underwriting the 1950 Delhi Agreement that brought democracy to Nepal, and the subsequent support to Nepali Congress workers who ran their anti-Panchayat campaign from India. While Nepal’s political leadership – both the monarchy and in the current republic era – have signalled a desire to redefine the terms of the 1950 agreement and thus the ‘special’ characteristic of the bilateral relationship, at that time, Indian influence over Nepal’s politics was not understated. As such, while Nepal’s leadership strove to break away from Indian influence and saw Chinese aid as one factor that could help it do so, Delhi policymakers in turn desired closer affinities to secure its strategic interests. To this end, it often discouraged the awarding of aid contracts or projects that seemingly fell within its sphere of interest – such as the East-West Highway, which ran parallel to the southern border with India – to China. As Mihaly wrote, “The military importance of Nepal lay not so much in its mountains as in its large valleys and in the twenty-mile-wide strip of plain in the south. Seen from the Indian side, the danger was that a hostile force could establish airfields and logistics facilities in these areas”⁴⁷.

Although the East-West Highway was first studied by the Soviets, whose support was sought to build the highway as well, no donor was keen on the project. But when Kathmandu signed an agreement with China to build a section of the highway between Janakpur and Biratnagar in 1963, Indian (and American) displeasure was imminent⁴⁸. The project was instead handed over to India, with Nepal too sensitive to Indian interests particularly after the 1962 war, and the chill in relations following the Lhasa-Kathmandu Highway and King Mahendra's 1960 takeover of government. Instead, Nepal requested China to build the Pokhara-Kathmandu highway as an alternative.

On the other hand, the Indian aid programme suffered under the weight of both its expectations as well as India's political role inside Nepal. India's relative lack of interest in Nepal's hydropower sector until the 21st century can be attributed to the backlash it received after signing the 1954 Kosi River and the 1959 Gandak river agreements. In both agreements, India was criticized for inequitable provisions that were against Nepal's interests, although Nepal did not make any monetary investments in the projects. A similar critique was levelled at India after the 1996 Mahakali River agreement as well.

Indian infrastructure assistance to Nepal was also marked by what Nepali policymakers saw as an overbearing priority towards Indian interests than for Nepali benefit. For example, the Trishuli hydropower project commenced in 1958, but by 1962, India was still working on building an access road to the site. The project was finally commissioned in 1967, and the slow pace of construction 'could only be explained by indifference or incompetence'⁴⁹ – or the fact that it had no strategic value to India, unlike the Tribhuvan Highway or the Kathmandu airport, both of which were finished in record time by India. 'The political and strategic importance India attached to its aid program of the 1950s and 1960s become fairly obvious as most of the aid allocated was used to build roads, airfields, and communication networks'⁵⁰.

These critical differences with Chinese aid resulted Nepal's policymakers viewing Indian aid less positively than the former. However, India continued to remain Nepal's largest donor from the mid-1960s until the 1970s, when Japan emerged as Nepal's largest donor for a few years.

1990-2008: civil war, political instability and transition to a republic

By 1990, Nepal had experienced over three decades of autocratic Panchayat rule, and four decades of foreign aid, with more than 40 percent of Nepal's development expenditure being funded by foreign sources⁵¹. While poverty alleviation and economic growth were the obvious *raison d'être* for foreign assistance, empirical data suggests that 'there was no evidence of a decline in poverty' between 1975-76 and 1995-96, when the National

Living Standard Survey (NLSS), based on the model of the Living Standard Measurement Surveys developed by the World Bank, was conducted for the first time⁵², and on most indices, Nepal was worse off. Further, many Nepalis still did not have access to basic infrastructure. Electricity supply was a ‘distant dream’ in rural Nepal, private telephones were ‘basically’ not available outside the towns, while only 29 per cent of the surveyed rural areas had public telephones – but even these were on average 45 minutes away. In road infrastructure, while urban areas had roads, a rural Nepali was on average three-and-a-half hours away from a dirt road, and five-and-a-half hours away from a paved road⁵³. Commentators had begun to question the efficacy and delivery mechanisms of aid, including on the accountability of aid⁵⁴. Foreign debt as percentage of GDP had also grown to more than 40 percent by the early 1990s, while the inflation rate was more than 20 percent at the beginning of 1991-92⁵⁵.

Under Panchayat, Nepal had outlawed political parties, although parties such as the Nepali Congress (NC) had maintained a resolute opposition to the monarchy’s direct rule. A referendum on whether Panchayat rule should continue or not was held in 1980. It is widely believed that the referendum was rigged in favour of the monarchists, but in another ten years, discontent against Panchayat had grown exponentially. In the spring of 1990, a massive public uprising demanded the king to reinstate political parties. King Birendra finally lifted the ban on political parties and formed an interim government under NC leader Krishna Prasad Bhattarai. A new constitution was promulgated in November 1990 establishing a parliamentary democracy, with the king now as a constitutional monarch⁵⁶.

The introduction of the multiparty system promised to usher in a new era of socio-economic development. The seismic political change was also seen against the background of the fall of the USSR and the Cold War’s end. Although the polity opened itself up to a variety of political actors, the nature of politics itself saw little change, with no party able to command a majority, and frequent government changes becoming a norm. Patronage politics, which was the hallmark of the Panchayat system, continued into the multiparty system. ‘If the Palace had been the sole source of crony capitalism until then, the [Nepali Congress] leadership soon learnt the tricks of the trade’⁵⁷.

The Nepali economy saw notable reforms in the early 90s following the elections in 1991, with an increased focus on private sector participation in the economy, privatization of state-owned enterprises, and other macroeconomic structural reforms including import tariff reforms and administrative reforms such as new Civil Service Act in 1993 under the IMF’s Enhanced Structural Adjustment Facility programme⁵⁸. Until then, Nepal had followed an import substitution model with an economy that heavily relied on public sector enterprises. The economic reform process also saw foreign exchange rate reforms,

and new investment policies including in the aviation sector, which was opened up to private airlines⁵⁹. This led to a period of sustained GDP growth, peaking at over 5 percent in the 1990s. The share of foreign aid to GDP, which had risen to almost 10 percent of GDP in the 1980s and peaked to 15 percent of GDP by 1990, began to steadily decline, reaching 6 percent of GDP by 2002. Bilateral aid still constituted a majority of foreign aid, and grants continued to constitute almost two-thirds of Nepal's foreign aid, despite the expansion of loan mechanisms⁶⁰.

However, the frequent changes in government – in the 18 years between 1990 and 2008, Nepal saw 14 prime ministers, some terms lasting less than a year – meant many of these economic reforms continued to stutter and be modified according to the political ideology of the prime minister. While political change had occurred at the helm, and economic growth was sustained, there was very little of the benefits that the Nepali citizen could perceive in reality. While economic reforms gave succour to the urban classes, the existing urban-rural and socio-economic divide was so vast that very little of the economic growth could be perceived in the rural areas. This gave momentum to the 1996 declaration of People's War by a group of Communist politicians who had veered to the extreme left of the political spectrum and formed the Communist Party of Nepal (Maoist).

The Maoists, although participants in the 1990 revolution, disagreed with its goals and demanded a constituent assembly that restructured the Nepali state. They saw the Nepali Congress' capitulation towards a constitutional monarchy as a betrayal, and the subsequent economic reforms as a turn towards market neoliberalism. Further, the NC also invited within its ranks several former Panchayat leaders. Disappointed with the state of politics, the Maoists submitted a 40-point demand to the government in 1996, and said they would resort to a People's War if the demands were not addressed. No one expected the government to pay attention to the demands, and as such, on 13 February 1996, the Maoists launched their war by attacking seven simultaneous government institutions in six districts.

Initially, the People's War was viewed by the Nepali state as a law-and-order problem, and for the first five years of the civil war, very little attention was paid to the issue. This changed in the early 2000s, precipitated by two crucial events – one domestic, the other international – that eventually led to the creation of the Federal Republic of Nepal.

The first was the June 2001 Royal Massacre, in which the majority of the royal family was assassinated. This event resulted in the coronation of King Gyanendra, who was the younger brother of King Birendra. The second was the 9/11 terrorist attacks on the US, which resulted in a change in global discourse on extremism and terrorism, and resulted in the Maoists being labelled as terrorists both by the US and Nepal.

King Gyanendra's rule was marked by a turn towards the authoritarianism practiced by his father, King Mahendra. He mobilized the Nepal Army against the Maoists, betting that a well-organised and well-funded military would be able to defeat a guerrilla army in absolute terms. However, this led to an escalation of the war. Government budgets began to increasingly be oriented towards defence and military expenditure as the size of the military and security forces began to expand to double the original size. The Nepal Army grew to about 90,000 soldiers by 2005 from 45,000 in 2001, while 18,000 forces were deputed from the Armed Police Force and 10,000 Nepal police personnel were deputed to the unified command under the Army⁶¹.

Development budget and infrastructure spending began to decline, especially since the state began to lose administrative control over several remote districts. Nepal's military expenditure rose from 0.9 percent of GDP in 1996 to a record high of 1.9 percent by 2005⁶². Military and security forces expenditure rose from 8.09 percent of the budget in 1996-97 to 13.15 percent of the budget by 2003-04. In the same period, development expenditure declined from 56.6 percent of the budget to 40.86 percent, indicating a shift away from Nepal's development and infrastructure orientation⁶³.

The impact on Nepal's economy was profound. Between 1990-2001, Nepal's GDP increased by 5.3 percent per annum and per capita income rose by 2.5 percent. However, in 2002, negative GDP growth was recorded for the first time in 19 years. 'A slowdown in revenue growth and a sharp increase in security expenditures created an unprecedented budget crisis. The shortfall in revenue and difficulties in implementing development programs in conflict areas reduced development spending by about 20 percent. As the budget crisis deepened in 2003, development spending, in real terms, fell to a ten-year low. GDP growth did recover in 2003 and 2004, registering a 3.4 and 3.7 percent growth rate. The corresponding growth rates for 2005, 2006, 2007 and 2008 were 2.4, 2.9, 2.7 and 5.3 percent'⁶⁴. Macroeconomic indicators such as investments, trade, exports and tourist numbers declined heavily during this period.

By 2006, Nepal had once again outlawed political parties and imposed a state of emergency suspending all fundamental rights as part of the war effort. However, popular discontent against the king's decisions, and backchannel communications between the parliamentary parties and the Maoists, meant by November 2005, the political parties and the Maoists had come to an understanding to oppose the king via a common front, leading to the second *Jana Andolan*, or People's Revolution, in April 2006. After a month-long nationwide uprising against the monarchy, an interim government was formed in May 2006, and by November that year, the Comprehensive Peace Accord was signed with the Maoists, bringing the decade-long civil war to an end and the Maoists to the political mainstream.

By 2008, Nepal had agreed to overthrow the monarchy and become a secular and federal republic state. Elections for a constituent assembly held that year saw the Maoists emerge as Nepal's foremost political party.

Nepal's Civil War, Bilateral Military Aid and China's response

As seen above, the civil war required a significant reallocation of financial resources towards the government's war effort. After the 9/11 terrorist attacks, with US policy on global terror outfits witnessing a dramatic shift, the US designated the Maoists as a terrorist group in October 2003. India and the US were major providers of lethal military aid to Nepal during the civil war, while Belgium, the UK and China also supplied military aid to Nepal. The US allocated over USD 29 million in grants to Nepal between 2001 and 2004 to pay for 'US weapons, services and training'⁶⁵.

India, the US and the UK have had significant defence cooperation with Nepal since the 1960s. A secret defence procurement agreement reached in 1965 between India and Nepal said India would supply all the requirements of the Nepal Army, and 'American and British assistance would be sought only when India was not in a position to supply the necessary equipment'⁶⁶. During the civil war, the UK provided substantial lethal military aid to Nepal both as grants and as commercial purchases, while by April 2003, India had provided arms and ammunition worth USD 25.8 million (while committed to another USD 12.9 million in weapons)⁶⁷. A Belgian minister was forced to resign over controversies arising out of the export of 5,500 guns to Nepal in 2002, as the arms transfer contravened the European Union (EU)'s code of conduct, and other EU member states had denied similar applications by Nepal. Belgium had also not insisted on the end-use monitoring of the weapons. Similarly, other States such as Germany, France, Kyrgyzstan, Poland and Israel also conducted commercial military deals with Nepal during this period.

In 2005, however, with King Gyanendra's imposition of martial law and declaration of Emergency led to the suspension of all fundamental rights and ban on political parties. In response, India, the US and the UK suspended all lethal military assistance to Nepal. However, China emerged as an alternative source of lethal military aid, sending 18 truckloads of weapons in November 2005 worth about USD 1 million⁶⁸. It was alleged that the subsequent crackdown on Tibetan refugees inside Nepal was the result of China providing military assistance to Nepal as a quid pro quo measure. As the American charge d'affaires reported the Nepali consul-general in Lhasa telling her in 2005, "It is not by choice but by compulsion" that Nepal had cracked down on Tibetan refugees and bought arms from China⁶⁹.

Foreign Aid and Infrastructure Development in Nepal Between 1990-2008

The following section provides a few case studies on notable infrastructure projects in Nepal that saw bilateral engagement in some form or the other between 1990 and 2008, i.e., after the re-introduction of multiparty democracy in Nepal. The case studies are also notable given that several of them were plagued by multiple issues – mostly related to corruption, but also by lacklustre performance of foreign contractors and institutions, as well as institutional weaknesses on Nepal's part. These case studies have, in the past, raised serious questions about Nepal's agency with donors and public procurement laws.

Kaligandaki A Hydroelectric Project

The Kaligandaki A Hydroelectric Power Plant, generating 144 MW electricity, is situated at a distance of around 180 km from Kathmandu, and spans across six different districts – Syangja, Gulmi, Parbat, Palpa, Kaski, and Rupandehi. A study of the project began in 1979, but construction could only begin in 1997. The project had a total construction budget of USD 360 million. ADB and Japan Bank for International Cooperation (JBIC) each loaned USD 160 million. The Italian contractor, Impregilo, along with the American engineering consultant Morrison Knudsen International Inc (MKI), invoiced NEA for USD 180 million⁷⁰. However, Nepal Electricity Authority (NEA) officials quietly paid an additional USD 50 million over five years without disclosing this to their board. Neither ADB nor JBIC, who funded the project, questioned the additional payments. Impregilo was awarded the contract after submitting the lowest bid of USD 130 million, but utilized a variation clause in the contract to claim the USD 50 million in cost-overruns⁷¹. The case showed a typical example of complicity between the foreign contractor and local Nepali officials in inflating project costs.

The project's progress was hindered by local resistance towards transmission lines in the Pokhara sector, which led to delays in its completion. The project was also affected by the Maoist civil war. The project was operationalized in 2002.

Melamchi Drinking Water Project

The Melamchi project has often been quoted as a classic example of corruption, delays and collusion in Nepal's infrastructure history. This case was repeated by almost all of our KIs as an example of how foreign assistance in Nepal is not what it seems like, with the KIs highlighting the role of multilateral institutions in its delay.

A large-scale infrastructure project in Nepal that aimed to supply clean drinking water to the Kathmandu Valley, which is home to over five million people now, was initiated

in 1998 and aimed to divert water from the Melamchi River to the Kathmandu Valley through a series of tunnels and pipelines. As of 2023, the project has finally begun to deliver drinking water to Kathmandu, but still faces issues. The project expected to supply around 170 million litres of water per day to the Kathmandu Valley, which would help to address the chronic water shortages and contamination issues that have been plaguing the Valley for decades.

In December 2000, ADB gave the green light to a loan which became effective on November 28, 2001⁷². However, the World Bank, the Norwegian Agency for Development Cooperation (NORAD), and the Swedish International Development Cooperation Agency (SIDA), who were co-financing the project, withdrew their support, resulting in a deficit of USD 133 million in the original cost projection of USD 464 million in 2000. NORAD and SIDA withdrew their funding commitment in 2005-2006, while the World Bank had withdrawn its support in 2002 after private companies were uninterested in assuming control of the water distribution system in Kathmandu⁷³. This caused a setback in project financing and prolonged the implementation.

In 2007, Hisila Yami, the newly appointed Maoist Minister for Physical Planning and Construction, declined to grant the water utility operator management contract to UK-based company Severn Trent Water International (STWI), which was recommended by ADB. Yami expressed reservations about STWI's reputation and criticized the fact that the contract had been given to them without competition⁷⁴. STWI had previously been found guilty of charging British consumers excessively and had been removed from its contract in Guyana. Additionally, its contract in Trinidad and Tobago was terminated due to public demonstrations⁷⁵.

In February 2008, ADB restructured the project, which primarily reflected financial and institutional changes implemented over six years and recommended the elimination of any identified implementation obstacles. Following the restructuring, the project was revised to a total cost of USD 317.3 million, with a completion time of June 2013. Multiple agencies jointly funded the project, including ADB contributing USD 137 million USD, JBIC providing USD 47.5 million, Japan International Cooperation Agency (JICA) providing USD 18 million, Nordic Development Fund (NDF) contributing USD 10.5 million, OPEC providing USD 13.7 million, and GoN contributing USD 90.6 million⁷⁶. After overcoming the financial obstacle, the project faced its greatest challenge when the contract for the Melamchi Tunnel was cancelled by Melamchi Water Supply Development Board (MWSDB) in September 2012 citing unsatisfactory performance of the construction company.

In 2009, the Chinese Railway 15 Bureau Group had been given the contract for the development of the tunnel⁷⁷, but they stopped working midway, causing the project to come to a standstill. Consequently, their contract was terminated. The Chinese company had obtained performance security and advance payment guarantee from China Construction Bank (CCB) while agreeing to the contract, with Himalayan Bank and Bank of Kathmandu (BoK) acting as their counter guarantors in Nepal. After the Chinese company left the project, USD 6.65 million in performance security and EUR 1.41 million in advance payment guarantee were acquired from the two Nepali banks. However, a dispute arose when the Chinese bank refused to reimburse the Nepali banks. This dispute was taken to a district court in China and subsequently to the high court, which ultimately favoured the Nepali banks which were reimbursed for the sums⁷⁸.

In June 2013, the Melamchi Tunnel contract was awarded to Cooperativa Muratori e Cementisti di Ravenna (CMC) of Italy for NPR 8.7 billion. ADB provided an additional \$25 million loan in February 2014 to complete the project. The completion target was September 2016 after the additional loan⁷⁹. The April 2015 earthquake damaged the roads leading to the project site⁸⁰, leading to a further delay and also a dispute with the contractor over the payment of NPR 362 million for additional works done by CMC after the earthquake extended the delay⁸¹. Two high-ranking officials from the Italian company, who spoke anonymously with the media, claimed that the same government officials who had previously demanded bribes from CMC were involved in halting the additional payment recommended by the independent third-party committee. They named Gajendra Kumar Thakur, a former secretary at the Water Supply Ministry, and Surya Raj Kadel, the executive director of the Melamchi Water Supply Development Board, as the officials responsible for demanding a 3 percent commission from the discounted NPR 300 million that was to be paid to CMC. CMC had earlier fired its project director when the company learnt he too had been siphoning money off as commission.

In a clear case of how corruption operates in Nepal, CMC had submitted a lumpsum bill of NPR 1.56 billion on top of the original contract sum in 2016. The bill included NPR 190 million that had been paid to GoN officials but was listed under the category 'loss in efficiency'. This sum was used to pay off GoN officials⁸². Despite repeated reminders, the GoN refused to pay CMC, leading the contractor to cancel its contract in December 2018. GoN officials thought "if the payment was released in full to the Italians, they'd flee without paying the local subcontractors"⁸³.

The case also displayed a clear example of how Nepali middlemen assisted in sustaining the corruption nexus in the country. CMC officials told the media that payments to GoN officials would be routed through Dinesh Shrestha, the primary subcontractor with other

business interests. Shrestha's multiple companies were supplying and transporting goods for the project, and the commission intended for GoN officials would be included within the payments for such supplies. Two other transport companies were also used for routing payments to GoN officials using fake invoices. Under pressure due to the continuing delays in the project, GoN attempted to renegotiate with CMC to return to Nepal. However, CMC refused to return to the project. In December 2019, GoN barred eight members of the team from flying home, accusing them of fleeing the country, and seized their passports, causing a diplomatic issue that was resolved by the intervention of the Italian Embassy in Delhi. CMC officials did not return to Nepal thereafter.

Subsequently, the Chinese company Sinohydro Corporation Limited was given the contract in 2019⁸⁴. Sinohydro had won two separate contracts of digging the tunnel and the headwork of the project, eventually completing the project in 2020⁸⁵. However, landslides and floods destroyed the headworks of the project in June 2021, thus forcing GoN to create a temporary arrangement until a permanent solution could be found.

Multiple KIs we spoke suggested the Melamchi project as one of the prime examples of how corruption persists in Nepal. A KI who worked with a multilateral institution earlier said that contract management had always been poor in Nepal despite multiple attempts for improvement, and that "bad behaviour" is regularly rewarded in the country. The Melamchi case also revealed the collusion between private Nepali subcontractors and agents and GoN officials in furthering corruption. In an indication of how international contractors operate – and in turn, how the Nepali ecosystem works – a CMC official told a newspaper, "We had no intention of not completing Melamchi... The intent was always to complete that project and to start Tanahu Hydropower, and to continue to bid for other projects"⁸⁶. CMC officials also faced regular hassles that were perceived as harassment. The linkages between the Nepali private sector and GoN officials reflect a local-level cronyism that creates delays in implementation and inflation in costs. These linkages are subsequently built up in local level contracts as well, and sustain the corruption ecosystem.

Mahakali Treaty

In the 1980s, India unilaterally constructed the Tanakpur Barrage on the Mahakali river, which is the border between the two countries in the west, to replace the aging Sarada Barrage. Its primary objectives were to provide irrigation to 1.61 million hectares of land in India and generate hydroelectric power. The construction sparked a controversy, leading to the negotiation of the Tanakpur Agreement between Nepal and India in 1991, wherein the GoN provided an area of around 2.9 hectares of land to connect the left afflux bund of the Tanakpur Barrage to a higher ground⁸⁷. Through the Tanakpur agreement, Nepal was promised an initial 10 million units of free electricity. This however drew criticism in

Nepal for its acceptance of the terms of the treaty, including the transfer of 2.9 hectares of Nepali land to India under the Tanakpur Agreement. This later led to the signing of the Mahakali Treaty in 1996, and has a 75-year term and includes clauses for arbitration and review every ten years. This treaty outlined the comprehensive development of the Mahakali River, including the Sarada and Tanakpur barrages, as well as the Pancheshwar Dam Project resolving the earlier criticism⁸⁸. The treaty also provisioned Nepal with 70 million units of free electricity generated by the Tanakpur Barrage⁸⁹.

The Mahakali Treaty generated a significant amount of controversy, involving politicians, activists, and civil society organizations in both Nepal and India. One of the key points of contention was the existence of undisclosed clauses and signatories. In 2009, a Nepali newspaper reported that secret clauses were present in the treaty, which granted India the authority to construct dams and barrages on the river without Nepal's consent. However, the Nepali government refuted these allegations, denying the existence of any undisclosed clauses in the treaty.

It was alleged that former Nepali Prime Minister Girija Prasad Koirala had signed a clandestine agreement with India on the Mahakali Treaty in 1996, with regards to undisclosed signatories⁹⁰. However, Koirala refuted these claims and emphasized that the treaty was negotiated and signed in a transparent manner. The controversy over the treaty also resembled similar allegations of India encroaching upon Nepali sovereignty and undercutting Nepal's share as seen in the previous Gandak and Koshi river treaties. The Mahakali treaty is notable in that it continues to be a politically divisive issue and has clouded the perceptions towards Indian projects in Nepal.

CHAPTER II

Aid, Infrastructure and Influence: China's Expanding Engagement in Nepal Since 2008

Summary

China has remained a major bilateral partner for Nepal since the establishment of diplomatic ties in 1955. Infrastructure has been a key area of Chinese assistance both inside Nepal and across the world over the years. Under its flagship BRI, energy and transportation projects constituted around 65 percent of China's infrastructure investment in 2021. In South Asia, a considerable number of Chinese projects in countries like Sri Lanka, Nepal, Maldives, and Bangladesh have been related to transport infrastructure and energy.

China's exact aid and financial disbursement figures are challenging to validate as it is not a part of the Development Assistance Committee (DAC) at the Organization for Economic Cooperation and Development (OECD). However, China is the largest donor outside of the DAC, and its foreign assistance has grown significantly in the 21st century. During the first five years of BRI implementation (2013-2017), China's overseas development finance program expanded greatly, with China outspending the United States by more than two to one.

In Nepal, Chinese assistance and investments have steadily grown since 2008, when the country became a republic. Chinese assistance to Nepal should also be viewed in the context of Nepal's relations with India, particularly after the economic blockade imposed by India in 2015. China has provided both vocal and material support to Nepal during these periods and has engaged closely with Nepali security agencies on issues related to Tibetan exiles.

China's engagement in Nepal's infrastructure projects has been driven by both political motives and commercial interests. The establishment of the Chinese International Development Cooperation Agency (CIDCA) in 2018 further institutionalized Chinese aid in Nepal. Chinese influence among Nepal's Communist parties has been a key driver of Chinese interest in infrastructure projects, particularly where interests of both parties intersect. Chinese infrastructure development in districts bordering Tibet Autonomous Region (TAR), such as Rasuwa and Sindhupalchowk, suggests a strategic objective of securing the Tibetan

frontier. However, Chinese foreign direct investments in Nepal have not grown at the same pace as its infrastructure engagements, indicating that commercial interests may not be the primary driving factor.

China's aid and engagement in Nepal have included a wide range of projects, including infrastructure development, food aid, and support to schools, community centres, hospitals, and medical services. Chinese companies have been involved in hydropower projects in Nepal, and China has also provided loans for infrastructure development. Chinese companies have also been involved in several infrastructure projects financed by other institutions. However, questions have been raised over China and/or its companies swinging infrastructure projects and contracts in their favour using their political networks within Nepal.

Chinese companies have also been at the receiving end of Nepal's domestic political swings, as seen in the Budhi Gandaki hydropower project, which was initially awarded to China's Gezhouba Group Co. Ltd without a tender in 2017. However, under Sher Bahadur Deuba's prime ministership, the contract was cancelled due to transparency concerns. It was once again given back to Gezhouba when K.P. Oli took office, but the subsequent government headed by Deuba once again scrapped the agreement.

China and/or its companies have also introduced the Engineering Procurement Construction (EPC) model in Nepal, with the Pokhara International Airport (PIA) built by China CAMC Engineering under this model, and financed by a China EXIM Bank loan. The awarding of the contract to CAMC was controversial, with questions raised over the contract awarding process as well as the design and construction of the airport itself. Although the airport was inaugurated in January 2023, the airport is yet to see any scheduled international flights. The Chinese Embassy in Nepal also claimed the PIA to be a flagship project under China's Belt and Road Initiative (BRI), which raised a new set of controversies.

Contracts awarded to Chinese companies in other infrastructure projects have been scrutinised for the procurement process, transparency issues with allegations of corruption, and delays in execution. Nonetheless, Chinese contractors have played a significant role in Nepal's infrastructure sector since 2008, in line with China's growing political influence as well as economic clout, allowing contractors to secure projects by being the lowest bidder. Some Chinese companies have also been blacklisted both by Nepali and multilateral authorities for shoddy performance.

China's aid architecture

Since the founding of People's Republic of China (PRC), China's overseas infrastructure investment and trade has constituted an integral part of its foreign policy goals. In the days of Mao Zedong, China's foreign aid required that it provide "selfless assistance to third world countries infrastructure construction"⁹¹. In the case of Nepal, according to former Chinese Ambassador Yang Gongsu⁹²: "In order to help Nepal's construction and resist the harsh conditions of aid from India and Western countries, China provided interest-free, low-interest and donated loans and projects to Nepal in accordance with the eight principles of my country's foreign aid at that time"⁹³.

Although China was itself a developing nation, it started providing aid assistance to several developing countries from the late 1950s onwards, including Nepal. In 1963-64, Premier Zhou Enlai outlined the eight principles governing China's aid policy in Ghana. Some of these policies continue to be outlined by China in its current aid policy as well. These policies were:

1. Chinese assistance would be based on principles of equality and mutual benefit
2. China would respect the sovereignty of recipient countries and attach no conditions to such aid
3. Chinese loans would be provided without interest or at low interest rates
4. Chinese aid would make recipient countries self-reliant instead of making them dependent on China
5. Chinese aid would target low investment but quicker yield projects
6. China would provide its own equipment and material at market-competitive prices
7. China would train personnel from recipient countries to use such equipment
8. Chinese technicians would enjoy the same living standards as their counterparts in recipient countries did⁹⁴

Large foreign aid projects in developing countries were one of the hallmarks of Chinese assistance, with foreign aid amounting to 5.9 percent of government spending between 1971-75, peaking at 6.9 percent in 1973⁹⁵. China embarked upon massive economic reforms starting from 1978 onwards, following which it transformed from a donor to net receiver of aid⁹⁶. Since the reform and opening up in 1978, China has also shifted from economic aid to more commercial assistance.

In 2011, the State Council of the PRC came up with guidelines on foreign aid with eight types of foreign assistance. One such guideline is based around infrastructure. In contrast to the economic selfless assistance ideology of the 1960s, infrastructure development in developing

countries has now become a channel for China to improve its image overseas and become a major power in international affairs. China's own development through four decades of reform and opening up reflects how it views adequate infrastructure as essential to economic growth and is keen to promote the narrative of infrastructure-led economic growth as the cornerstone of prosperity and progress. Scholars like Min Ye, Professor of Boston University, state such phenomena as China's "state-mobilized globalization" with a broad political rhetoric that can be interpreted and responded differently by various national and sub-national actors⁹⁷. As the Chinese saying goes, "to get rich, one has to build roads first", its infrastructure aid has largely constituted of hard infrastructure i.e. railways, hydropower, telecommunication, and the like.

In 2021, the share of energy and transportation as a part of Chinese infrastructure investment constituted around 65 percent of total overseas investments under its flagship Belt and Road Initiative (BRI)⁹⁸. Out of its overseas investments in South Asia, between 2003 to 2019, 23 projects out of 30 in Sri Lanka were related to transport infrastructure, while 2 in Nepal out of 5, 3 out of 7 in Maldives and 3 out of 17 in Bangladesh with majority being in extraction pipelines and energy⁹⁹.

As China is not part of the Development Assistance Committee (DAC), a forum of the world's major donor nations at the Organization of Economic Cooperation and

Development (OECD), its exact aid and financial disbursement figures are difficult to validate. However, it is the largest donor outside of the DAC, and Chinese foreign assistance has grown by leaps and bounds in the 21st century. As AidData research on Chinese overseas assistance suggested, '[D]uring the first thirteen years of the 21st century (2000-2012), China and the United States were overseas spending rivals: average annual development finance commitments from China amounted to \$32 billion and average annual development finance commitments from the U.S. were roughly on par (nearly \$34 billion). However, during the first five years of BRI implementation (2013-2017), China's overseas development finance program underwent a dramatic expansion, with Beijing outspending Washington on a more than two-to-one basis. China spent \$85.4 billion a year (on average) and the U.S. spent \$37 billion a year (on average) during this period¹⁰⁰. However, these figures also include projects for which Chinese financial commitments were secured or committed, but may not have been executed on ground.

According to the 2021 White Paper on China's aid practices issued by the Chinese government, China's total foreign assistance between 2013-2018 was USD 39.4 billion (270.2 billion RMB), distributed between three categories: grants, interest-free loans, and concessional loans. Almost half of this sum – USD 18 billion (127.8 billion) – was spent on grants, while interest-free loans accounted for 4.18 percent of the total disbursement.

Concessional loans worth USD 19.1 billion (131.1 billion RMB) were disbursed during this period¹⁰¹. China had provided assistance to 122 countries around the world, with 53 countries in Africa (44.65 percent of total disbursement) and 30 countries in Asia (36.82 percent) being the primary recipients, and infrastructure being the primary focus. In 2022, the Chinese foreign minister said over USD 3 billion had been delivered out of the USD 10 billion credit facilities pledged to African financial institutions at the 2021 Dakar Forum on China-Africa Cooperation conference, and China had channeled nearly USD 2.5 billion in loans to the continent¹⁰². A study estimates that China had financed loans worth USD 153 billion to African governments and state-owned enterprises between 2000 and 2019¹⁰³. An overwhelming share of this financial flow went towards infrastructure projects, with Chinese infrastructure financing for sub-Saharan Africa between 2007 and 2020 being as much as 2.5 times of all other bilateral institutions combined¹⁰⁴.

Nepal received USD 380.45 million as development assistance from China in the period 2016-17 to 2020-21¹⁰⁵, with China being the fourth-largest bilateral donor to Nepal¹⁰⁶.

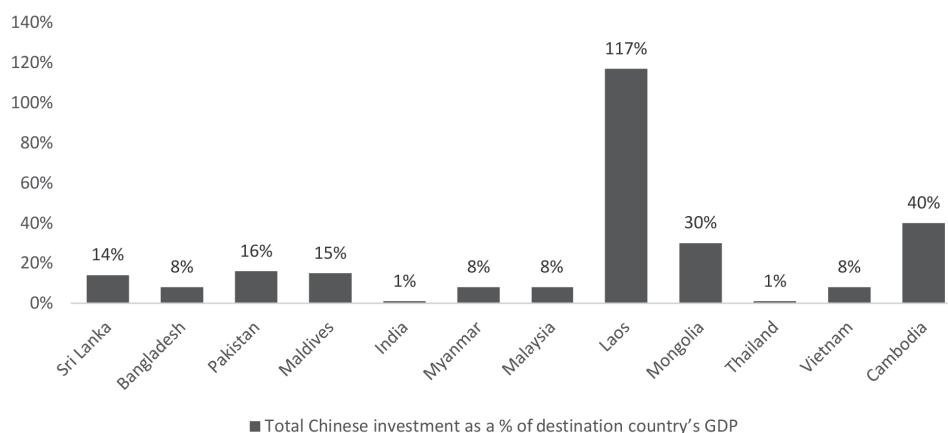
Table 1. Chinese Aid Disbursements During FY 2016/17 to 2020/21 (USD)

S.N.	Fiscal Year	Aid Disbursement (in \$US) for Different Projects (Grants, Interest free loans & Concessional loan)
1.	2016/17	41,244,254
2.	2017/18	58,727,078
3.	2018/19	150,370,540
4.	2019/20	93,026,787
5.	2020/21	37,081,650

Source: Nepal Development Partner Profile Book, FY 2020/21

Compared to the rest of South Asia, Nepal has received significantly less financial assistance and investments from China in terms of absolute numbers. For instance, Pakistan, which enjoys a significant defence and military cooperation with China, has received at least USD 25 billion in Chinese investments since the establishment of the landmark China-Pakistan Economic Corridor (CPEC) in 2015¹⁰⁷. China and/or its companies also made up a third of all Foreign Direct Investment (FDI) received by Pakistan in 2018-19, with Pakistan's debt owed to China by June 2022 being nearly USD 6.7 billion¹⁰⁸. Similarly, Sri Lanka received USD 12.1 billion in Chinese investments in its infrastructure in the period between 2006 and 2019, equal to 14 percent of Sri Lanka's 2018 GDP¹⁰⁹.

Figure 1. Total Chinese Investment as a % of Destination Country's GDP (2018)



Source: LKI calculations based on data gathered from the American Enterprise Chinese Investment Database and the IMF, World Economic Outlook Database.

Similarly, in Bangladesh, Chinese investments in infrastructure totalled an estimated USD 9.75 billion in the period between 2009-2019¹¹⁰. In contrast, in the period between 2000-2017, AidData estimated that Nepal had received USD 4.5 billion in all Chinese investments. However, this data set also includes pledges such as the USD 1.6 billion pledged by China Export Import (EXIM) Bank as a loan commitment towards the West Seti Hydropower Project, which has now been handed over to India's National Hydroelectric Power Corporation (NHPC) Ltd¹¹¹. The actual figure of Chinese investments in Nepal during this period, thus, will be lower than the estimate.

While in 2011, China described its approach as foreign 'aid', its release of the 2021 White paper on the Belt and Road indicates the BRI being seen as "international development cooperation" as opposed to "foreign aid" domain. Moving beyond the concept of 'economic aid', China's approach to BRI in the white paper is seen more as to "gain legitimacy among both international and domestic audiences"¹¹². These includes cooperation not only with hard infrastructure, but also soft infrastructure like exchange programmes, scholarship for higher education, training for political parties' leaders etc.

Actors in China's aid approach

China's aid approach is not uniform. Given the magnitude of its overseas investments, there are different national and sub-national actors involved in the process within the

Chinese institutional mechanism. Research on China's foreign aid by Zhang and Smith's 2017 paper¹¹³ identifies at least 30 different ministries and agencies involved in China's foreign aid programme. At the central level, there is the Ministry of Finance and Commerce (MOFCOM) which regulates almost all activities of Chinese companies overseas. Prior to 2012, research by Carol Lancaster's 2007 report¹¹⁴ has shown greater influence of the State Council. However, in the Xi Jinping era, the State Council has become more of an implementing agency as opposed to a policymaking body.

In 2018, China established the China International Development Cooperation Agency (CIDCA), the country's first centralized foreign aid agency under the State Council and directly reporting to foreign minister. With Nepal, CIDCA signed cooperation agreements with the Ministry of Finance during the visit of the then Prime Minister KP Oli in 2018 to provide development assistance¹¹⁵. In 2019, CIDCA vice-Chairman Deng Boqing visited signed an agreement to provide assistance to 15 northern districts of Nepal that border Tibetan Autonomous Region (TAR) of China¹¹⁶. Despite being the centralized foreign aid agency, it still presents itself as a monitoring agency as opposed to planning and implementing funds in negotiation with recipient countries. In terms of the official bilateral creditor, concessional loans are granted by MOFCOM on the basis of inter-governmental

agreements, and agreed upon by the CIDCA¹¹⁷. Hence MOFCOM continues to play an important role in foreign aid and it has in-country presence and sends staff to run Economic and Commercial Counsellor's offices in almost all Chinese diplomatic missions overseas¹¹⁸.

Apart from government agencies, Chinese State-Owned Enterprise (SOE)s in recent years have become important actors in China's overseas investment activities. After the late 90's "Going Out" policy, the SOEs, which were designed to implement, rather than drive the policies, became increasingly active in generating and seeking new projects and exerting significant influence in domestic politics¹¹⁹. Chinese SOEs saw two major shifts in international operation. As of 1994, SOEs were supposed to "establish foothold as policy implementers in host country via donor-based assistance projects"¹²⁰. However, in 1996, an operational strategy was devised to "further development on exploration of new markets and new fields"¹²¹ that allowed SOEs to play a larger role in procuring infrastructure projects overseas. For instance, Gezhouba group, responsible for infrastructure projects in South Asia like Pakistan's Neelum Jhelum Hydropower project¹²², got its first ever international overseas contract in 1996 with the Upper Bhotekoshi Hydropower Project in Nepal. As of 2006, MOFCOM had listed 12 Chinese enterprises in Nepal. By 2016, MOFCOM identified 30 SOEs in the country¹²³.

Changing Nature of Chinese Assistance in Nepal

Although Nepal has received the lowest Chinese investments in South Asia, Chinese assistance and investment in Nepal should not necessarily be gauged on its absolute value, but should consider other factors including influence building, political alignment, and Nepal's adherence to the One-China policy. In fact, Chinese investments in Nepal have been steadily growing since 2008, the year Maoist leader Pushpa Kamal Dahal 'Prachanda' became the first prime minister of republic Nepal, signifying significant shifts in its policy from the days of the monarchy.

Till 2008

Nepal was among the first non-socialist countries to which China provided aid, with an aid agreement being signed in 1956. Some estimates suggest Nepal received USD 98.7 million in aid from China in the period 1956-1972, and by 1973, Nepal ranked 11th in terms of volume of Chinese aid outflow among recipient countries¹²⁴. Among South Asian nations, Chinese grant assistance to Nepal was also the highest in proportion to total aid in this period, with 44 percent of total aid as grants, almost double than that of Pakistan at 25 percent¹²⁵.

Scholars have pointed out that while China enjoyed an extensive military and security-based relationship with Pakistan, Chinese aid to Nepal was centered on reducing Indian influence and expanding its own influence. To this end, a significant proportion of Chinese aid was directed towards Nepal's physical infrastructure needs, although China had to withdraw from projects such as the East-West Highway due to Indian objections. 'Till at least 1990, over...65 percent of total Chinese assistance was targeted towards the construction of roads, irrigation plants, airports, power and water supply systems'¹²⁶. China also donated logistic material worth USD 1.3 million for the first Constituent Assembly elections to be held in 2008, as well as a meteorological satellite data receiver in 2007.

Some of the major infrastructure projects either funded or developed by China between 1956-2008 were the Arniko Highway connecting Kathmandu to Lhasa, the Prithvi Highway connecting Pokhara to Kathmandu, the Pokhara-Baglung Highway, the Narayanghat-Mugling Highway, the Kathmandu Ring Road project, the Trolley Bus public transportation system, the Kathmandu-Bhaktapur Road, the Seti Hydropower and Irrigation Project in Pokhara, the Sunkoshi Hydroelectric Project, and the Nepal Television Metro Channel Station expansion and improvement project¹²⁷. Several Chinese projects were also geared towards the manufacturing of consumer goods such as shoes, textiles, bricks, paper, and sugar, ostensibly – as several scholars have argued – to reduce Nepal's economic dependence on India. Almost all China's projects in this period are located within the hilly region of Nepal, confirming Mihaly and several other scholars' assertion that Nepal was not too keen

on Chinese projects being located in the Terai plains which are perceived to be politically and ethnically closer to India, and thus located within her sphere of interest¹²⁸. Also, China's infrastructure projects, particularly in road transportation, are situated within urban centres such as Kathmandu and Pokhara. Further, especially during the tumultuous period of the Cultural Revolution when the Communist Party of China was keen to export its Maoist ideology to other nations, Chinese aid workers, technicians and labour were reported to have conducted propaganda theatre and distributed Maoist literature to the Nepali people during the construction of the Arniko and Prithvi Highways¹²⁹.

Although accurate figures on the total volume of Chinese aid received by Nepal are difficult to come by, another scholar suggests between 1956 and 1989, 'China provided grant assistance for 42 projects, 36 of which were completed by the latter year... Since 1981, Chinese firms have also bid for various contract projects and undertaken labor cooperation, technical consultancy, and joint ventures. By late 1989 Chinese firms had signed 85 contracts worth USD 137 million for work in Nepal, five Chinese companies-maintained offices in Kathmandu and more than 1,000 Chinese workers and experts were working in Nepal'¹³⁰.

A key element in Chinese assistance to Nepal is that it must be viewed on the backdrop of Nepal's relations with India, especially after the 1989 and the 2015 economic 'blockades' imposed by India on Nepal. In 1989, after India shut down 13 of the 15 border transit points and halted all petroleum exports to Nepal, Chinese transport aircraft ferried 300 tonnes of petroleum products to Nepal, with another 300 tonnes being transported by road. It is unclear whether China paid the transport costs or Nepal, but the fuel costs were much higher because of the transport costs. Subsequent to the assistance, which was insignificant in sum but more important in substance, China and Nepal began discussions on expanding road connections between the two countries. China also extended a USD 13.6 million grant towards new projects in Nepal, including a new convention centre in Kathmandu, which currently serves as the Parliament building¹³¹.

The advent of multiparty democracy in Nepal did not necessitate a dramatic shift in China's Nepal policy. Chinese president Jiang Zemin became the first Chinese president to visit Nepal in 1996. China also agreed to build the Syaprubesi-Rasuwadhi border crossing road in 2001, a second highway connecting Kathmandu to Lhasa. However, the road to the border crossing would only be completed in 2013. Despite the then finance minister announced the construction on the road would begin in 2006¹³², it began in 2008 after China provided a USD 32.5 million grant in end-2007, with the highway estimated to cost USD 20 million. However, domestic political transformation from 2006 onwards played a key role to change Chinese approach towards Nepali actors and investments in the country.

China had rebuked the Maoists during the Nepali Civil War (1996-2006) as besmirching the Chinese leader's name and labelled them as 'armed anti-government forces', with Chinese president Jiang Zemin saying China supported King Gyanendra's efforts to crack down on the Maoists¹³³. Although the Maoists had attempted to reach out to China during the civil war, such attempts did not get any traction due to China's long association with the Nepali monarchy. King Birendra was the first foreign leader to visit Tibet in 1976, two years after the Nepal Army successfully quelled the Tibetan Chushi Gangdruk guerrilla movement being operated out of Nepal's Mustang region. China also supported King Birendra's 'Zone of Peace' proposal that the latter outlined as a foreign policy goal for Nepal during his coronation in 1975, a move that made India suspicious of the Nepali monarch's motives with the proposal. In February 1978, Deng Xiaoping visited Kathmandu in a trip that was intended to showcase a break away from the Mao era and the beginning of China's economic reforms. In 1989, after the Indian-imposed blockade, Chinese premier Li Peng visited Kathmandu and said China would always support Nepal to safeguard her independence¹³⁴. China had also offered military aid to Nepal after King Gyanendra declared an emergency during the Civil War and suspended all fundamental rights, leading to Nepal's leading arms suppliers such as India and the US cutting off military aid to the country. In return, King Gyanendra shut down the Dalai Lama's offices in Kathmandu, cracked down on Tibetan political demonstrations, attempted to bring China into South Asian Association for Regional Cooperation (SAARC) as an observer, and began to refuse to issue travel documents to Tibetan refugees travelling to India¹³⁵.

Nepal and China also negotiated a purchase of two Chinese Modern Ark (MA)-60 aircraft in 2005 in a controversial deal that was finally executed in November 2012. Under the original agreement, King Gyanendra's regime and the Nepal Army had pushed for the purchase of the two aircraft in 2005 at the behest of a local representative, Sharad Chandra Shah. Nepal then sent an advance of USD 5 million, with the two aircraft priced at USD 8.5 million each. The interim government formed after the 2006 movement wanted to scrap the deal, but the local representative Shah allegedly got Chinese authorities to pressure the new government to stick to the deal or forfeit the advance. Nepal would have ended up paying almost USD 8 million extra for the two aircraft that were not certified by international authorities, but the deal did not go through until it was incorporated within the purchase of six Chinese aircraft by Nepali flag carrier Nepal Airlines in 2012¹³⁶.

The Nepali monarchy was thus seen by China as a permanent institution inside Nepal to safeguard its interests, and as such, China did not engage widely with Nepali political parties and other institutions compared to other bilateral partners such as India and the US. However, with the abolition of monarchy in Nepal and the declaration of a republic state, China was forced to recalibrate its approach inside the country. Starting March

2008, several anti-Beijing Olympics demonstrations also took place inside Kathmandu, led by Tibetan activists in exile. This led China to prioritise its security interests related to Tibet inside Nepal, leading Kathmandu to become what commentators labelled the outermost ‘security ring’ in China’s crackdown on Tibetan protests¹³⁷.

China’s presence in Nepal since 2008

In August 2008, Prachanda made his first official state visit to the closing ceremony of the Beijing Olympics, signalling a break in the tradition of Nepali prime ministers visiting Delhi first after assuming office. By November 2009, China had begun to interact closely with Nepali security agencies on the issue of political activism by Tibetan exiles, both on the northern border and in Kathmandu. As during the royal regime under King Gyanendra, security cooperation also took the form of supplies and equipment such as riot control equipment, and between March 2011 and January 2012, three high-profile visits took place, with the chief of general staff of the People’s Liberation Army (PLA), China’s domestic security chief, and finally Chinese premier Wen Jiabao all visiting Nepal in this period. During the latter’s visit, China offered Nepal USD 113 million in aid and USD 20 million special grant¹³⁸. China and Nepal also concluded a grant agreement worth 200 million RMB in 2013, under which China would build and hand over an academy for the Nepal Armed Police Force, responsible for border security¹³⁹. Designed by Hong Kong consultancy Fruit Design and Build Ltd, the construction was executed by China Railway 14 Bureau Group, and used Chinese workers during the construction period. It was handed over to Nepal in 2017, two years after construction began^{140,141}.

Development cooperation similarly began to see an upswing since Nepal became a republic, with the two countries signing a USD 200 million loan deal in November 2009 to be financed by China EXIM Bank, under whose terms USD 120 million was earmarked for the Upper Trishuli 3A hydropower project, and the remaining sum for other projects¹⁴². A former Nepali government official who worked closely with the foreign aid department said the remaining sum of the loan was to be earmarked for Pokhara International Airport and the purchase of the aforementioned Chinese aircraft. Although the tender for the Upper Trishuli 3A was awarded to China Gezhouba Group Co. Ltd in 2010 itself¹⁴³, the contract would be effective only once the loan agreement with China EXIM Bank was finalized. A USD 90 million loan agreement with China EXIM Bank was finalized in 2011 for the project at 1.75 percent interest rate, 25-year maturity period, and a five-year grace period. However, in 2013, the scope of the project was expanded and the face value of the loan agreement increased to USD 114.7 million. In 2017, China EXIM Bank rescheduled the payment terms, increasing the grace period by another 4.5 years after Nepal cited lack of progress due to natural disasters¹⁴⁴.

In June 2011, a committee led by the Energy Ministry Joint Secretary recommended an increase in the capacity of Upper Trishuli 3A to 90 MW from initial capacity of 60 MW. This decision was later approved by Prime Minister (PM) Baburam Bhattarai's cabinet in January 2013¹⁴⁵. The debate between the 60 MW and 90 MW options was contentious, with some arguing that the 60 MW option was more practical and financially viable, while others argued that the 90 MW option would provide greater benefits. The controversy surrounding the upgrade decision also centred around allegations of abuse of power, party interests, and violations of procurement laws. Some argued that the decision was made to benefit certain individuals or groups rather than based on the project's merits. A writ was filed at the Supreme Court, arguing that awarding the 90 MW upgrading project to China Gezhouba Group Corporation (CGGC) without competition was against the Public Procurement Act (PPA)¹⁴⁶. However, the court refused to issue a stay order stating that the NEA Board had not yet approved the Cabinet's decision¹⁴⁷. Additionally, five former ministers submitted a petition to Khil Raj Regmi, Chairman of the Council of Ministers, on June 6, 2013, requesting that Upper Trishuli 3A's capacity be retracted to 60 MW¹⁴⁸. They argued that the decision was against the law and favoured the contractor's interests.

The NEA Board's decision to award the contract for the 90 MW project to CGGC at a cost of USD 132 million was also seen as controversial, given the previous contract for the 60 MW project had been awarded to the same company with a "subject to" clause as well as with a clause stating that bidders can suggest for project enhancements. The NEA board decided to stick with the original 60 MW capacity in June 2013. The project was operationalized in 2019.

In 2008, China provided a RMB 25.4 million grant for a 155-km-long Kathmandu–Khasa optical fibre laying project along the Arniko Highway. The implementation contract was signed between China International Telecommunication Construction Corporation (CITCC or China Telecom) and Nepal Telecom (NT). According to the Chinese Ministry of Finance Investment Guide 2018, although the project completed construction in 2008, the communication carrier services on both sides did not establish connection, and Nepal used the fibre network for domestic communication use. In 2016, China extended its optical fibre network from Lhasa to Nepal via Geelong (Kyirong)-Rasuwgadhi border point and handed it over in August same year. In 2018, China Telecom and Nepal Telecom completed compatibility works and Nepal was officially connected to the Internet via Chinese fibre networks¹⁴⁹.

In 2009, China also began supplying food aid to Nepal's northern districts bordering TAR. The programme today covers all 15 of Nepal's TAR-bordering districts. CIDCA took over the programme from the TAR government. From food aid, the development assistance

programme today covers road infrastructure, health infrastructure, school buildings and irrigation channels, and new pilot development projects being planned since 2021. While 13 pilot projects have been identified but not named, China's assistance to the northern districts has also been viewed by some commentators as arising out of China's security interest in Tibet. The scale of the projects is said to be low, with each pilot project not costing more than NPR 50 million. 'In a deal signed by Nepal and China in 2014, China... agreed to provide 10 million yuan (\$1.63 million) annually from 2014 to 2018' to the 15 bordering districts¹⁵⁰.

In a sign that the Maoists in Nepal and the Chinese Communist Party had reached suitable levels of understanding, in 2010, Maoist leader Krishna Bahadur Mahara was caught on tape asking a Chinese businessman for NPR 500 million. The funds were purportedly to be used on seeking the support of members of Parliament to re-elect Prachanda as prime minister¹⁵¹. Prachanda's government had to resign after the President Ram Baran Yadav refused to endorse his firing of the then Nepal Army chief.

In February 2011, under the prime-ministership of UML leader Jhala Nath Khanal, China agreed to expand the Kathmandu Ring Road in phases, with the Phase 1 grant sum amounting to USD 33 million. Khanal, who led the government with Maoist support, would also approve a USD 3 billion investment plan by the Asia Pacific Exchange and Cooperation Foundation, a Beijing-based organization said to be backed by the Chinese government, for the construction of mega infrastructures in Lumbini in 2011. Prachanda was also associated with the organization¹⁵². However, the project was discontinued after alleged pressures from the Indian government.

Nonetheless, Chinese aid and engagement continued to expand in Nepal, with financial and material assistance provided to schools, construction of community centres, and hospitals and medical services. In 2012, China EXIM Bank also approved a USD 116.3 million loan for a 50 MW Upper Marsyangdi A hydro project to a special purpose vehicle called Sinohydro-Sagarmatha Power Company Ltd, a private sector joint venture between Sinohydro (which owns 90 percent of the stake) and Sagarmatha Power Company Ltd (10 percent). The total cost of the project was USD 165.9 million, and was financed under a 70:30 debt-to-equity ratio, with the loan terms being at 6 percent interest rate, 4-year grace period, and 15-year maturity. The project came into operation in 2016¹⁵³. Environmentalists have noted that the river has gone dry six km downstream of the Upper Marsyangdi A project. Three hydropower projects are already in operation on the river, while four more have been granted generation licenses, and eleven have been planned on a stretch of 140 km of the river¹⁵⁴. The 600 MW Upper Marsyangdi project on the same river had been taken up for development by Indian infrastructure developer Grandhi

Mallikarjuna Rao (GMR), but the company pulled out¹⁵⁵. Subsequently, the project's potential power generation was reduced to 327 MW, and a Chinese-Nepali consortium consisting of Sichuan Transportation Investment Group (SCIG), International Nepal Hydro Joint Development Company Pvt. Ltd., Xingcheng International Investment Company Ltd., Qingyuan Engineering Consulting (QYEC) International Co. Ltd., and Butwal Power Company Ltd have taken up the project, which is currently under survey¹⁵⁶.

That same year, China EXIM Bank also pledged to finance USD 1.6 billion towards the 750 MW West Seti hydropower project, which was one of the two marquee hydropower projects China and/or its companies were keen on developing inside Nepal (the other being the Budhi Gandaki project)¹⁵⁷. The project received a boost when China Three Gorges International Corporation (CTGIC), a subsidiary of China Three Gorges Corporation, decided to invest in 75 percent of the project. The Nepal Electricity Authority signed an agreement with the company in 2017, but by 2018, the company had begun to say the project was financially unfeasible due to high resettlement and rehabilitation costs. In 2019, the government announced it would develop the project on its own in a sign that discussions with CTGIC had not gone smoothly. In 2022, Nepal then awarded a redesigned 1200 MW West Seti and Seti River projects to Indian SOE NHPC Limited¹⁵⁸.

China also signed an agreement to provide 750 million RMB as grant assistance towards unspecified infrastructure projects in 2012, with China providing 200 million RMB annually for three years and 150 million RMB over the course of the three-year-period. It is unclear where the grant assistance has been utilized¹⁵⁹. That same year, China announced USD 20 million as direct budgetary assistance towards the rehabilitation of former Maoist combatants during the short visit of Premier Wen Jiabao to Kathmandu. However, the agreement had not been implemented as of 2018¹⁶⁰.

Xi Jinping Era

In 2012, Xi Jinping was elected as general secretary of the Chinese Communist Party (CCP) and chairman of the Central Military Commission, effectively making him the president of China (he was formally chosen as President in March 2013). In 2013, Xi outlined the 'Community of Common Destiny' as a Chinese foreign policy goal, under which China began to expand its engagement in its neighbourhood. As Xi said, "China needs to develop closer ties with neighbouring countries, with more friendly political relations, stronger economic bonds, deeper security cooperation and closer people-to-people contacts"¹⁶¹. That same year, Xi also put forth an ambitious multinational economic and infrastructure connectivity proposal known as the One Belt One Road (OBOR) strategy within China, and which was renamed for international audiences as the Belt and Road Initiative (BRI).

In April 2015, after two massive earthquakes caused widespread devastation and loss of life in Nepal, China was one of the first responders to the disaster. China also committed RMB 3 billion to Nepal for 25 post-earthquake reconstruction projects in June 2015, with focus areas being infrastructure, livelihood recovery, cultural and historic sites reconstruction, and in the public health sector. Although Nepal's Aid Management Information System records the value of the grant at USD 483 million, as of 2019, it recorded two disbursements of USD 12.7 million under the programme¹⁶². Under the same commitment, China also initiated the Araniko Highway Long-term Maintenance Project after the highway was damaged in several places following the earthquake. China committed NPR 760 million for Phase 1 of the project, which was completed by 2017¹⁶³. Prior to the earthquake, China had also committed towards building an inland container depot in Timure, near the Rasuwagadhi border crossing, covering all costs excluding land acquisition. The project was estimated to cost USD 19.4 million. Construction began in 2019 after Tibet Fuli Construction Group Company Ltd was selected as the contractor¹⁶⁴. However, progress has been slow on the dry port after the Covid-19 pandemic.

The year 2015 also saw promulgating a new constitution, which was contested by several interest groups over several issues such as federalism, provincial boundaries, women's citizenship rights, and electoral representation¹⁶⁵. Although India had recommended delaying the promulgation of the constitution to accommodate the protesting groups, Nepali lawmakers in Kathmandu saw India's response as another instance of Delhi's meddling in Nepal's domestic politics. Violent protests ensued once the constitution was adopted in September 2015. Local protestors in the Terai plains decided to pressure the government in Kathmandu by blocking off major border crossing points with India. Delhi was seen to be supporting the protestors by halting the movement of goods across the border, and its stance on the constitution was also in contrast to the other bilateral partners such as the US and China, all of whom acknowledged the new statute. The halt in imports from India – particularly that of petroleum products and other essentials – was seen as Delhi's attempt to force Nepal's hand into revising the statute's clauses, and was labelled as an economic blockade, which India is yet to acknowledge.

As during the 1989 blockade, the 2015 blockade also drew a similar response from Kathmandu's policymakers and leaders to break away from India's economic stranglehold over Nepal. However, China's response was mostly limited to moral support during the 1989 blockade, as the goal of reorienting the Nepali economy towards China was a difficult task at that time due to limited connectivity and infrastructure between the two countries. By 2015, in contrast, China had expanded its transport infrastructure inside the TAR at a massive pace due to its 'Xibu da Kaifa' – 'Great Western Development Strategy' – initiative, which was started in 1999¹⁶⁶. The Qinghai-Tibet Railway (QTR) connecting

Lhasa to Beijing was operationalized in 2006, with goals of expanding the railway network up to the Nepal border and creating a 4,000 km train network within TAR by 2025. TAR authorities also intend to build 14 new airports by 2025¹⁶⁷. Some researchers have also suggested that China has begun imagining Tibet as the main gateway to South Asia, and the plateau ‘can evolve as the anchor for China’s three proposed land corridors crisscrossing the Indian sub-continent—the China-Pakistan Economic Corridor (CPEC), Bangladesh-China-India-Myanmar (BCIM) Economic Corridor, and the China-Nepal-India Economic Corridor—and link them to the maritime corridor, thereby forming the trans-Himalayan Economic Belt that will ensure China’s sustained economic rise’¹⁶⁸.

Because of the sustained and rapid infrastructural expansion inside TAR, Nepal was able to sign a petroleum agreement with China in October 2015 amid the blockade on the Indian border, breaking India’s monopoly over the supply of petroleum products to Nepal¹⁶⁹. Petro China then gifted Nepal 1.2 million litres of petroleum products, which was intended to ameliorate the acute shortage Nepal faced as a result of the Indian unofficial blockade. Although the volume of petroleum products was not adequate to satisfy Nepal’s domestic demand, analysts and observers have interpreted this as a move ‘expected to reduce India’s influence in Nepal and increase Beijing’s clout’¹⁷⁰.

Indeed, during the PM and UML leader K.P. Oli’s March 2016 visit to China, Nepal signed a trade and transit agreement with China that allowed Nepal the use of seven Chinese ports – four sea and three land ports – for importing goods from third countries. However, although the protocol to the agreement was finalized in 2019, the agreement had made ‘no headway’ up to 2021¹⁷¹. The joint statement during Oli’s visit also mentioned that Nepal had requested China to provide assistance on the Kimathanka–Dhankuta road in the east of the country, build a 400 Kilovolt (KV) cross-border power transmission project, and provide financial and technical support towards the feasibility study and detailed project report of the Kyirong-Kathmandu and Kathmandu-Pokhara-Lumbini railway project among others¹⁷². During the same visit, Nepal’s Ministry of Finance also signed a loan agreement with China’s EXIM Bank, under which the latter would provide RMB 1.37 billion, or USD 215.96 million, as funding for the Pokhara International Airport. Twenty-five percent – or RMB 355.9 million – of the EXIM Bank loan would be concessional at zero percent interest, with a maturity of 20 years and a 7-year grace period. The remaining 75 percent – RMB 1.02 billion – would be provided at 2 percent interest rate, 20-year maturity and 7-year grace period¹⁷³. Oli laid the foundation stone for the airport in April 2016, and in June 2016, GoN sub-loaned the loan agreement to CAAN at a 5 percent interest rate. ‘Construction was delayed after China EXIM bank set a condition that a joint escrow account should be set up into which CAAN — the project executing agency — would have to deposit the income generated from all its airports in Nepal. CAAN refused

to do so which delayed the release of the project funds, and construction of the airport stalled. However, CAAN and China EXIM bank eventually agreed in 2017 to the deposit of revenues generated by Pokhara International Airport (PIA) into the escrow account¹⁷⁴.

In December 2015, China CAMC Engineering initiated a feasibility study on the Kathmandu-Pokhara railway, which it submitted in June 2016. The study said the 165-km-long railway line would have 27 tunnels and 53 bridges, with an estimated cost of USD 2.8 billion, or around USD 17 million per km¹⁷⁵. China also provided a grant worth NPR 4.5 billion or USD 42.91 million that same year to expand the Syaprubesi-Rasuwagadhi road, with Tibet Tianlu Company Limited given the contract to do the same. The project was to be funded from the post-earthquake reconstruction grant committed by China in 2016¹⁷⁶.

Nepal and the BRI

In May 2017, Nepal signed up to become a member of the BRI. By June 2018, Nepal had submitted a list of 35 projects to be included under the BRI, but brought it down to nine after Chinese insistence. The nine projects Nepal has submitted under the BRI are:

- 1) Upgradation of Rasuwagadhi-Kathmandu highway
- 2) Kimathanka-Hile road construction
- 3) Road from Dipayal to China
- 4) Tokha-Bidur road
- 5) Galchhi-Rasuwagadhi-Kerung 400kv transmission line
- 6) Kerung-Kathmandu rail (feasibility study)
- 7) Tamor hydroelectricity project (762MW)
- 8) Phukot Karnali Hydro Electric Project (426MW)
- 9) Madan Bhandari Technical University¹⁷⁷

In September that year, China agreed to conduct a survey and pre-feasibility study on the Tibet-Nepal railway, leading from the Tibetan border town of Kerung to Kathmandu. The train line, however, would have to cross some of the world's most difficult terrain in the Himalaya. By December 2018, the National Railway Authority of China had submitted a pre-feasibility study of the train, while Nepal began to insist that China entirely fund the detailed project report (DPR), which would itself cost NPR 35 billion and take two years to complete¹⁷⁸. The train line itself was estimated to cost NPR 257 billion, with 98.5 percent of the line either bridges or tunnels, and would take around nine years – with an estimated expenditure of NPR 28.55 billion per year¹⁷⁹. Nepal has said it would seek a grant from China if the project moves ahead, since it does not have the technical expertise or financial means for the scale of investment. China hasn't committed to the project as a grant. However, in December 2022, a Chinese team landed in Kathmandu to carry out a

feasibility study of the railway, which would cost RMB 180 million or NPR 3.4 billion and would be fully borne by China¹⁸⁰.

The Chinese team landed in Kathmandu, for the feasibility study of the railway just a day after Maoist leader Prachanda became prime minister for the third time with the support of CPN (UML) leader K.P. Oli. This was not the first time China had openly expressed a preference for communists being in power in Nepal. In 2018, after the first general elections since the 2015 constitution, Oli and Prachanda came together and merged their parties to form the Nepal Communist Party. Several observers expressed the belief that China had convinced the Left parties in Nepal to come together. This belief was further cemented by the fact that the Nepal Communist Party (NCP) and the CCP signed a formal agreement to expand party-to-party ties in September 2019, which led to multiple interactions between members of the two parties. The NCP also decided to train its cadre in 'Xi Jinping Thought', with President Xi Jinping himself visiting Nepal in October 2019.

Xi's 2019 visit can be seen as the culmination of China's decade-long engagement with Nepal's Communist leaders, during which period China had been successful in suppressing Tibetan political activity inside Nepal, reduced India's political and economic influence and emerged as an alternative during the 2015 Indian blockade. China also expanded its economic and commercial activities inside Nepal through contract works in both bilateral and multilateral-led infrastructure projects. China had also been successful in presenting itself as a panacea to Nepal's development and infrastructure needs, as seen in the electoral slogans by Oli during the 2017 elections which promised a train from China to Nepali voters. As a result, Xi's visit was high on expectations from the Nepali side, not least because it was only the second visit by a Chinese president after Jiang Zemin's visit in 1996.

During Xi's visit, Nepal-China ties were elevated to 'strategic partnership', and the two countries signed a Border Management System and Mutual Legal Assistance Treaty. China had also allegedly asked for an extradition treaty but this was rejected by Nepali officials. The two countries agreed to include BRI projects within Nepal under the larger framework of the Trans-Himalayan Multi-Dimensional Connectivity Network, with focus on ports, roads, aviation, railway, and communications¹⁸¹. Among the 20 agreements signed during the visit, China agreed to upgrade the Rasuwagadhi-Kathmandu highway, and the two countries agreed on a joint implementation mechanism in the energy sector¹⁸².

Although Xi Jinping's visit could be said to have provided a new momentum to Nepal-China relations, very little progress has been seen on the ground since then, both on the agreements signed during Xi's visit and on the proposed nine BRI projects¹⁸³. While Nepal's lack of preparation and technical expertise, and the Coronavirus Disease 2019

(Covid-19) pandemic from 2020 onwards, have been quoted as reasons for reduction in Chinese engagements and standstill of BRI projects, there is widespread agreement both among KIs and analysts that the political instability arising out of the discord between Prachanda and Oli – which led to the collapse of the NCP within two years of its formation, despite numerous political meetings by the Chinese ambassador and a visit by the vice-chairperson of the CCP's International Liaison Department, Guo Yezhou, in December 2020 to stem the collapse of the NCP – resulted in the slowdown in Chinese engagements since 2019.

Another reason for the slowdown in Chinese engagements has also been Nepal's inability to proceed on several investment agreements with China, such as the 1200 MW Budhi Gandaki hydropower project. The reservoir-based project was awarded to China's Gezhouba Group Cement Co. Ltd without a tender after an agreement with Nepal's Energy Ministry in May 2017. Prachanda was the prime minister at the time. Gezhouba agreed to develop the project on an EPC plus financing model, but in November that year, Nepali Congress chair Sher Bahadur Deuba assumed office as prime minister and cancelled the contract stating lack of transparency around the tender awarding process. In September 2018, Oli, who became prime minister after the 2017 elections, gave the project back to Gezhouba. However, Gezhouba grew disinterested in the project, which was estimated to cost USD 2.5 billion in 2015 including resettlement costs¹⁸⁴. Deuba, who became prime minister again in April 2022, once again cancelled the contract, saying the project would now be developed using Nepal's own resources. Nepal has been raising money for the project through a cess on petroleum products since 2015, and had raised nearly NPR 100 billion by September 2022. However, there has been no movement on the project since then, despite the Energy Ministry registering Budhi Gandaki Jalbidhyut Public Limited as a company in September 2022¹⁸⁵.

The Covid-19 pandemic resulted in the slowdown of several infrastructure works, including those contracted to or being developed by Chinese contractors such as the Pokhara International Airport. As work began to resume, PIA was inaugurated in January 2023 after the Prachanda government took office. However, the airport came under the scanner when no international flights were scheduled, the design of the airport itself was critiqued, and other local issues such as the clearance of a landfill site nearby. Two weeks later, a domestic airline crashed while landing at the new airport.

China and the Nepali Left: a politically expedient partnership since 2008

China's expansive engagement since 2008 has been accredited to governments friendlier to its concerns and interests in Nepal under Left leadership. Beijing's great power aspirations in this period also meant China and/or its companies had begun to expand their scale

of operations at a global level, not just in Nepal but in the rest of South Asia and other developing countries across the world. In Nepal, as seen above, China preferred politicians from the Nepali Left, often increasing its engagement through signals such as inaugurating a new airport or announcing new grants when a Left-oriented government comes in power. Almost all bilateral infrastructure projects between the two countries since 2008 were announced when a Communist politician led the government.

Close party-to-party ties have been cultivated between the CCP and Nepal's Left parties, which have resulted in several interactions between their leaders – including over video call during the Covid-19 pandemic. 'China clearly accords considerable significance to having an ideologically aligned counterpart in Nepal's power structure, and its current ambassador, Hou Yanqi, has been especially active in the country's party politics... Infrastructure features heavily in the relationship'¹⁸⁶.

Such influence building has resulted in direct relationships between Nepal's border districts and TAR authorities on aid and other issues. Chinese public diplomacy has also extensively highlighted Nepal's tourism potential, with almost 200,000 Chinese tourists visiting Nepal in 2019 before the pandemic, and commentators citing the return of Chinese tourists as being vital to Nepal's tourism industry¹⁸⁷. China has also trained hundreds of Nepali civil servants and media personnel in an effort to expand its influence, while also granting scholarships to hundreds of Nepali students to study in China. Some of these students have also been appointed to government positions, such as the current foreign affairs advisor to the prime minister – Prachanda ¹⁸⁸.

The weak state of Nepal's institutions in this bilateral partnership is highlighted by the fact that several of the contracts that were awarded to Chinese developers – such as the PIA or the Budhi Gandaki project – without a tender process. Where a bidding process was called for – as in the case of the PIA – a preference was clearly shown towards a Chinese contractor. Several KIs highlighted the lack of transparency and accountability in such contracts, and the lack of participation or inputs from the Nepali side, such as in Phase 1 of the Kathmandu Ring Road Expansion Project, where the Nepali Department of Roads allegedly went ahead with the Chinese blueprint without studying it adequately, resulting in several questions about the city's arterial road's safety and suitability.

Several KIs also emphasized that with respect to infrastructure works funded by bilateral or multilateral mechanisms, Nepal had little say of its own, and its decisions to move ahead on a project were mostly influenced by factors other than technical and financial suitability of the contractor. In this, China and/or its companies were not too dissimilar from other actors. However, where China differed, apart from the lack of transparency, was that its

diplomatic mission was fully engaged in acquiring the support of Nepali actors towards its companies and contractors. This resulted in several backroom deals, as seen in the initial memorandum signed between the then finance minister and China CAMC Engineering over the PIA, that superseded Nepali laws and institutional mechanisms.

Although direct instances of outright corruption are difficult to trace due to the lack of a paper trail, China's engagement with Left politicians in Nepal has resulted in a weakening of an already fragile institutional mechanism. The expansive political relationship gives more weight to the reasoning that China would prefer a Left government in Nepal. This has also resulted in personal interests superseding the national agenda, which may not be specific to Left politicians in Nepal alone. Nonetheless, increasing Chinese engagement with Nepali Left politicians has meant other parties have tried to expand their engagement with foreign parties such as the ruling Bharatiya Janata Party in India as a counter, as the Nepali Congress has done. The prioritization of personal interests has also meant infrastructure projects in Nepal have often gone ahead without adequate planning and business models, as seen in the case of the two new international airports in Pokhara and Bhairahawa. This has resulted in new fears about Nepal's ability to pay back its external debts, which are not a cause of concern in the immediate future according to KIs. However, if such infrastructure projects funded by external sources continue to remain underutilized, such fears may well be realized.

Chinese bilateral engagements in Nepal's major infrastructure projects

Nepal's purchase of Chinese aircrafts¹⁸⁹

Reports emerged in the Nepali media in May 2005, at the peak of the civil war, that China offered a buy-two-get-one-free deal to sell MA-60 Chinese aircraft to Nepal. The Nepal Army and NAC were planning to purchase these planes for NPR 700 million each. However, China later decided to gift one MA-60 and one Yün-12 (Y-12) to Nepal for the purchase of one MA 60 and three Y-12E.

In 2012, Nepal Airlines went ahead and signed a deal for six Chinese aircraft that had been under the scanner since the royal regime. In 2013, China EXIM Bank agreed to loan RMB 218.8 million for the purchase of three 19-seater Harbin Y-12E and one 58-seater MA-60 aircraft, while the Chinese government announced a grant of RMB 180 million towards the purchase of one Y-12E and one MA-60. The terms of the loan were 1.5 percent interest rate, 7-year grace period, and a 20-year maturity. Reports suggest service charges and management expenses amounting to 0.4 percent of the overall loan will also have to be paid by Nepal¹⁹⁰.

The first batch of aircraft arrived in Nepal in 2014. The remaining airplanes were delivered in 2017-2018¹⁹¹. After their arrival, the first two Y-12E aircraft remained grounded for over two months due to a lack of pilots¹⁹². Former NAC Managing Director Sugat Ratna Kansakar claimed that the supplier of the aircraft had promised to provide Chinese pilots who could speak English. However, NAC could train only three pilots and one instructor pilot to operate the Y-12¹⁹³.

The MA-60 was grounded for 75 days during the first seven months of operation, costing more than NPR 20 million in maintenance. Delays in delivering spare parts led to further grounded days. The aircraft was also unable to operate at full capacity due to take-off weight issues. Similarly, the Y-12E had the same problem. The insurance cost for the MA-60 was higher than the average cost for new aircraft, reaching 4.7 percent of the total cost, due to these reasons. This was in addition to its inability to fly with full passenger capacity¹⁹⁴.

Both MA-60 aircraft were intermittently in operation till the end of 2018, but since January 2019, one has been out of commission while all four Y-12E have been stuck on the tarmac without use¹⁹⁵. In a bid to avoid incurring financial losses from expenses such as insurance, parking charges, and maintenance, NAC declared its intention to either sell or lease out the six Chinese aircrafts it had in its possession¹⁹⁶. However, in July 2019, NAC announced that the Y-12E planes would resume operations¹⁹⁷.

The interest on the aircraft loan cost NAC NPR 250 million annually from 2020 onwards. They were incurring the airline NPR 600 million in annual losses. In March 2020, one of the Y-12E crashed in Nepalgunj, undershooting the runway. Although the pilot was blamed, the performance of the Y-12E, which were supposed to be used on short take-off and landing (STOL) runways in the mountain regions, began to be questioned. Three months later, NAC decided to ground all the Chinese aircrafts for good¹⁹⁸. In 2022, NAC decided to sell the Chinese planes due to their high maintenance costs and low operational efficiency. The planes were causing financial strain on the already debt-ridden national carrier as they were spending more time grounded than in the air¹⁹⁹.

NAC then submitted a proposal with four options for the aircraft: to ask the manufacturers to buy back the planes; to lease them out to Nepali operators; to auction them off; or to look for Chinese or other international companies to lease or auction them off²⁰⁰. In December 2022, NAC decided to sell off the aircraft and called for bids²⁰¹.

The purchase of the aircraft had been under the scanner since its very inception in the royal regime, with reports indicating Nepali agents had forced the NAC in acquiring the aircraft. The PAC also opened an official probe into their procurement in 2015, but it isn't

clear whether the investigation was concluded²⁰². The aircraft had become a 'burden' for NAC as said by the then Minister for Tourism and Civil Aviation Kripasaur Sherpa in 2015 itself. Several authorities had complained about the lack of spare parts for the aircraft, but the root of the problem lay in NAC's purchase of the aircraft without having the pilots to fly them, and despite recommendations from Nepali civil servants against the purchase on grounds of their international safety clearances.

In November 2011, when an NAC expert team – along with a team from Bangladesh – were invited to China to inspect the aircraft before their purchase, the Bangladeshi team reported to their government the planes weren't suitable for their country. But the Nepali experts all approved the deal, and the GoN moved ahead on the purchase based on their recommendations²⁰³. The Nepali team was led by senior pilot Vijay Lama²⁰⁴.

Reports suggested local representatives of the Chinese aircraft company Aviation Industry Corporation of China (AVIC China) had been lobbying since 2010 to sell the aircraft for domestic routes, with the representatives themselves proposing a China EXIM Bank loan to secure the deal. But Lal Shankar Ghimire, the then head of the Foreign Aid Division at the Ministry of Finance, had recommended not to move ahead on the purchase of the said aircraft, citing the aircraft's lack of safety requirements, unsuitability for Nepali terrain, and the expensive EXIM Bank loan. Ghimire also reportedly argued that the purchase of the Chinese aircraft, which had not been certified for safety by European and American aviation standards, would see Nepal Airlines being downgraded on the Air Safety List. It was reported that former Prime Minister and Maoist leader Baburam Bhattarai had insisted Ghimire approve the proposal to purchase the aircraft, but when Ghimire did not do so, he was transferred from the Foreign Aid Division²⁰⁵. The EU imposed a ban on all Nepali airlines from flying to European destinations in December 2013. Both the EU and the United Nations International Civil Aviation Organisation have told Nepal it must break up CAAN's dual roles both as a regulator and service provider before the ban will be removed, an issue that is brought to the fore every time there is an air crash in Nepal (Nepali skies are among the deadliest in the world)²⁰⁶. While KIIs explicitly did not suggest the link between the purchase of Chinese aircraft and the EU ban, there have been suggestions that the ban is linked to NAC's purchase of aircraft that have not been certified internationally and do not match American and European safety standards. Several KIIs confirmed that a local Nepali businessperson, who also heads a conglomerate and has been involved with promoting Nepali tourism in China, was one of the key individuals associated with the deal. Nonetheless, the fact that there was no opposition towards the purchase of the Chinese aircraft despite their flaws being available in the public domain says a lot about China and its engagements in Nepal, a KI said.

Budhi Gandaki hydropower project (BGHP)

In 1984, the GoN commissioned a prefeasibility study of a hydropower project on the Budhi Gandaki River in central Nepal after a 1978 prefeasibility study by the Australian firm Snowy Mountains Engineering Corporation²⁰⁷. The prefeasibility study concluded the 600 MW full capacity storage dam type project was ‘technically sound and economically feasible’, with the internal rate of return calculated at 16 percent and capital cost at December 1983 prices at USD 774 million. In the 1990s, the BGHP saw interest from India, since the river is a major tributary of the trans-national Gandak river, but such interest did not materialize and was eventually withdrawn at a secretary-level meeting in November 1996²⁰⁸.

The project remained in limbo for the next decade-and-a-half before the Maoist leader Baburam Bhattarai’s government moved ahead with the project in 2011. During his premiership, a Budhi Gandaki Hydroelectric Project Development Committee was formed. NEA then selected TRACTEBEL Engineering SA from France to prepare a detailed design as well as a feasibility study of the project in December 2012. An environmental impact assessment was initiated in 2013, and the French consultants submitted a draft of the feasibility study in 2014, in which the project’s capacity was recommended to be increased to 1,200 MW. At the time, the GoN had chosen the project among those to be funded by the USD 1 billion line of credit facility offered by India²⁰⁹. The estimated cost at the time had risen to NPR 250 billion. In May 2015, the GoN decided to impose NPR 5 on the sell of every litre of petroleum products to raise funds for the project²¹⁰. By February 2016, the committee had determined that the project would displace 45,000 people, and the Ministry of Energy had asked the Finance Ministry to allocate NPR 29 billion in the budget towards the project, with resettlement costs alone expected to cost NPR 58 billion at the time²¹¹.

However, GoN began to rethink the decision to use the Indian credit line facility after the September 2015 undeclared blockade. The Parliamentary Agriculture and Water Resources Committee (PAWRC) then directed the GoN to develop the project using domestic resources²¹². Land acquisition for the project moved ahead in 2016, with the GoN earmarking 59,900 ropanis of land to be acquired²¹³. Politics around the project began to escalate once the Environmental Impact Assessment (EIA) was submitted in 2016, with the PAWRC warning the Energy Ministry to follow due process in awarding the contract²¹⁴. Already there were reports that the then K.P. Oli government planned to give the project contract to China Gezhouba Group Corporation (CGGC) under the EPCF model without a bidding process. The now retired Energy Secretary confirmed that the PM’s Office had asked the ministry to collect details of CGGC “along with a letter expressing its interest”²¹⁵. The Energy Ministry then wrote to the Finance Ministry

requesting it to contact the Chinese Embassy for “help”. The then finance minister Bishnu Paudel had “pushed hard to seal the deal”, but the Oli government backtracked after public outcry over the controversial decision²¹⁶. However, by April 2017, the Energy Ministry had once again revived the contract and prepared a draft MoU to be signed with CGGC after the new PM Pushpa Kamal Dahal ‘Prachanda’ was asked about the project during his March 2017 visit to the Boao Forum for Asia conference, with the Chinese government itself keen that a Chinese company develop the project²¹⁷.

Just days before leaving office, Prachanda’s government awarded the contract to CGGC under the EPCF model without a competitive bidding process on 24 May 2017²¹⁸. China EXIM Bank was reportedly ready to finance the USD 2.5 billion project, and according to the MoU, CGGC would have one year to assess the project and arrange for funds²¹⁹. The contract was reportedly signed in the presence of Prachanda and Chinese Ambassador to Nepal Yu Hong²²⁰.

The agreement immediately invited controversy. As a KI formerly with the Energy Ministry said, the role of the then Energy Minister Janardan Sharma was key while awarding the contract to CGGC. The contract was not properly discussed inside the ministry and the cabinet. The decision violated several laws of Nepal, and the track record of the company was not that good. CGGC had been developing the 30 MW Chameliya hydropower project in the far-west of Nepal and the 60 MW Upper Trishuli 3A project. The KII said that the contract was awarded to CGGC because of the manoeuvring of Chinese investors as well as local Nepali agents, who were frequently seen in minister Sharma’s office at the time. The Chameliya project ended up costing more than twice the original, and CGGC took over a decade to develop the project. The Chilime project had also terminated its contract with CGGC and seized the collateral. The deadline for the 60 MW Trishuli 3A was extended thrice by CGGC, and the company had also been blacklisted by the Sanjen hydropower project²²¹. An energy expert told a newspaper at the time that even if CGGC moves ahead with the project, the project costs would be inflated as Chinese companies “are notorious” for doing so²²². In September 2017, China listed the project under BRI according to Ma Yingying, executive vice-president of CGGC, and would be prioritized for funding²²³. The public accounts committee (PAC) of the Parliament instructed the government to submit all documents same month related to the deal because of the irregularities in the contract²²⁴. A joint meeting of the Agriculture and Water Resource Committee and Finance Committee of the Legislature-Parliament also instructed the government to scrap the deal due to the irregularities²²⁵. “First, the government awarded the contract breaching the regular process as well as the law. Second, the CGGC has a bad reputation for failing to develop the 22MW Chilime Hydropower Project. How can we trust such a company?” Finance Committee Chairman Prakash Jwala asked at the time²²⁶.

The decision to award the contract to CGGC must be seen against the background of the formation of the Nepal Communist Party in May 2018. It is widely believed that Beijing had backed the unified alliance of the two major communist parties. The KI said the nexus between minister Sharma, CGGC and its local Nepali agents, and K.P. Oli was the key reason behind CGGC getting the contract. Former prime minister Baburam Bhattarai in 2020 then alleged that Oli, Prachanda as well as NC President Sher Bahadur Deuba had “embezzled 9 billion rupees in commission” between them to award the project to CGGC²²⁷.

In November 2017, a new government was formed under the leadership of Deuba, which then scrapped the contract with CGGC citing the instructions of parliamentary committees. The Then deputy prime minister Kamal Thapa said the contract had been signed “illegally and haphazardly”²²⁸. The government then formed a panel headed by Vice Chairman of the National Planning Commission Swarnim Wagle to recommend a model on how to develop the project²²⁹.

Several KIs alleged that the contract was scrapped under diplomatic pressure by both India and the US, with the shoddy contract process under fire as well. Since the Budhi Gandaki is a major tributary of the Gandak river, the Gandak Treaty between Nepal and India bars Nepal from any kind of upstream activities that will lower the water flow into the Gandak. Indian authorities had expressed concerns about whether upstream activities such as constructing the Budhi Gandaki reservoir would impact its irrigation facilities. CGGC claimed the cancellation of the contract was ‘invalid’ due to the 30-day notice period not being given, and that the company was committed towards the project²³⁰.

However, the saga was not over. Before the December 2017 elections, KP Oli indicated that the next government would “correct any unauthorized decisions” taken by the caretaker government of Deuba²³¹. Issues had also come up with the land acquisition process, with hundreds of landholders yet to receive compensation despite their lands being earmarked for the project in 2015 itself²³². The proposed viability gap funding of NPR 94 billion also did not move ahead, keeping the project in limbo²³³.

In September 2018, the KP Oli government once again decided to award the tender to CGGC, with reports alleging Oli and Prachanda, along with senior UML leader Bam Dev Gautam, UML leader Bishnu Paudel and Maoist leader Janardan Sharma had all been lobbying for the same. Lobbyists had also been keen on convincing the NC to agree with the decision, while the Energy Ministry said it had been discussing the project with developers from India, China, Bangladesh and Australia, but both Oli and Dahal were inclined towards handing it over to CGGC again²³⁴.

CGGC's local agent Deepak Bhatta is known to possess influential political networks in Kathmandu²³⁵. A Nepali Congress leader and KI said the re-awarding of the contract to CGGC was not only because of Bhatta's lobbying, but also due to strong pressure from Beijing. Three different officials and party leaders said that China was keen on the project because Beijing wanted to show that its investment in Nepal had increased massively, and that it would have an upper hand in Kathmandu. KIs in the Energy Ministry said the proposal was taken to the Cabinet directly by the Prime Minister's Office (PMO) without involving Ministry officials. Key informants serving in the ministry at that time said CGGC had filed an application at the PMO, expressing interest in executing the project under the EPCF model.

The re-awarding of the contract to CGGC without a global tender was widely criticized, including by the NC, who raised the issue in Parliament. NC leader Gagan Thapa said the contract went against the country's laws, particularly the Public Procurement Act²³⁶. The EPCF model was also not in practice in Nepal, although there is no specific law on public procurement regarding the EPCF model. Thapa emphasized that he was not against China or investments from China, but over the manner in which the contract had been awarded. "The government can take loans from China. And the project can be awarded to a Chinese company through competitive bidding," said Thapa at the time²³⁷.

The contract process had also faced criticism from India, whose Prime Minister Narendra Modi reportedly told Oli in April 2018 that Nepal could develop as many dam projects with China as it wanted, but it should not expect India to buy the energy produced from such projects²³⁸. The project could not move ahead as CGGC could not arrange funds, with India's reservations and Nepal's inability to provide sufficient assurances on returns on investment as an additional factor. However, Nepal's domestic political uncertainty was also another reason. In December 2020, Oli dissolved the Parliament over differences in the power-sharing agreement with Prachanda, a decision that was eventually revoked by the Supreme Court. However, the unified NCP was no longer an entity, with the party reverting back to its original forms – and a split in the UML leading to the creation of the UML (Socialist).

A new government was formed with NC leading a new coalition, with Deuba becoming PM in July 2021. In April 2022, his government revoked the license issued to CGGC, and decided to build the project on its own. Then Chinese Ambassador Hou Yanqi expressed serious concerns over the scrapping of the deal during a virtual press conference, saying the policy inconsistency of GoN had put Chinese investors in trouble. "As the investors concerned also have to spend a long time preparing for a big project, the frequent change in

the government's policy put all their efforts in vain," she said²³⁹. The envoy also expressed her concern about Nepali authorities delaying the payments to Chinese companies. "Government changes are natural in democratic countries and it is their internal matter. However, a change in policies with the change in the government is a cause of concern," said Hou. "This affects the investors mainly in the large projects. Construction of hydropower projects or other industries take time where the investors make long-term planning and investment. However, a frequent change in policies affects them"²⁴⁰.

As of now, the project remains in limbo. Nepal has raised NPR 150 billion in the almost 6 and a half years since the petroleum cess was introduced. But the Budhi Gandaki Jalvidyut Company, set up for the project, had not been allocated any funds in the 2022-23 budget. Compensation for 50,000 ropanis out of the 60,000 required for the project had been distributed, with NPR 39 billion spent on the compensation. The company had been asking the government to allot it NPR 1 crore as its regular expenses, but it had not been forthcoming²⁴¹.

The Budhi Gandaki project is a clear example of Nepal's political leaders negotiating non-transparent and informal contracts with Chinese companies without following due process. By turning the awarding of the contract into a cabinet decision, Nepal's political leaders successfully bypass the public procurement laws as well as the scrutiny of the CIAA, which oversees graft investigation in the country. The continued involvement and lobbying of CGGC with Nepali Communist leaders – and the fact that only Nepali Communist leaders awarded the contract to CGGC while Nepali Congress leaders withdrew the contract – suggests that Chinese companies prefer to deal with Nepali Communists while the latter are in power.

A larger geopolitical analysis of the project leads one to conclude that Nepal has not paid sufficient attention to trans-boundary river issues such as in this project, and that the impact of geopolitics can be seen on Nepal's infrastructure needs as well. As a downstream country, India should have been consulted on the project, but it was clear that it was not, reflecting the trust deficit between the two countries. The project is also a clear example of how Nepal does not have any continuity in its policymaking, seen from the see-saw with which CGGC was awarded the contract and refused by successive governments.

The project is also a clear instance of how local Nepali lobbyists and representatives of foreign companies play a key role in the awarding of contracts, often on substandard and non-transparent terms that serve little benefit to the country. 'Agents', as they are locally

known, work primarily to smoothen the gears inside Nepal's labyrinthine bureaucracy and political system through their networks and the use of incentives, often as kickbacks. Their presence and influence act as barriers for other more eligible companies by directing contracts and tenders towards companies that are willing to pay them to grease the wheels. Nepal's agent ecosystem thus manipulates contracts and tenders to suit them, offer substandard services and products, manipulate the political process in their favour, and nurture close links with ruling parties in order to perpetuate the sorry state of Nepali infrastructure.

After the termination of the contract, China Gezhouba group stated that the termination of the contract will not affect Gezhouba group's new contract plans and production operation in year 2018²⁴². Gezhouba's reputation among the Chinese SOEs was unparalleled. In the same year, it was ranked 4th among the 4,300 Chinese enterprises "going global" in international business contracted value announced by the Ministry of Commerce²⁴³.

A KI from the Gezhouba group sent us the following as a response to our questions:

From the perspective of construction enterprises, it is believed that improvements can be made in the following aspects:

First, the principle of winning the bid with the lowest price in the Nepal Procurement Act should be improved. Winning the bid at the lowest price has led many companies to viciously bid without understanding the market and risks, which may eventually lead to termination of contract performance or serious losses. A reasonable bidding price will help the project to perform better and ensure the quality of the project.

The second is to respect partners and achieve a win-win situation to the greatest extent. Once the project was implemented, various problems were not resolved in time, and the construction period was eventually delayed or both parties resorted to court.

Third, plans and budgets should be updated in a timely manner according to market conditions. The Nepalese government often conducts bidding work with outdated plans and budgets, and does not proceed from reality, which may easily lead to a series of follow-up performance problems.

Budhi Gandaki project timeline

Date	Events
1978	The Budhi Gandaki Hydroelectric Project identified by SMEC and was investigated initially for 200 to 300 MW storage-based hydroelectricity project ²⁴⁴ .
April 1984	A 600 MW project was suggested during a pre-feasibility assessment of the Budhi Gandaki Project ²⁴⁵ .
2010/2011	The project was reevaluated by the NEA after a break of nearly 26 years, and it advised to conduct a feasibility and detailed design study ²⁴⁶ .
2012	The government-led by Dr. Baburam Bhattarai decided to develop the power project through Budhi Gandaki Project Development Committee ²⁴⁷ .
2015	Tractebel Engineering, a French company, proposed a 1,200 MW installed capacity with six 200 MW Francis turbines in its final feasibility and detailed design study ²⁴⁸ .
23 May 2017	A Cabinet meeting approved the Energy Ministry's proposal in principle to let the Chinese company (Gezhouba Group) build the 1,200 MW project under the EPCF model of project development ²⁴⁹ .
04 June 2017	CGGC was given the contract to construct the project under the EPCF modality by the then-Pushpa Kamal Dahal-led cabinet without undergoing a competitive bidding process ^{250,251} .
13 November 2017	As a result of the project's controversy over the contract being given to CGGC without competitive bidding, the Sher Bahadur Deuba government opted to revoke former governments decision ²⁵² .
27 November 2017	The government chose NEA as the project's new developer ²⁵³ .
22 September 2018	The Oli-led government made a cabinet decision to award the contract to develop 1200-MW hydropower project to the CGGC again without inviting competitive biddings from interested parties ^{254,255} .
October 2022	Former Prime Minister Bhattarai alleged that Prime Minister K P Oli and the former Prime Ministers duo Sher Bahadur Deuba and Pushpa Kamal Dahal had received Rs 9 billion in commission while awarding the contract for its construction to the Gezhouba Group ²⁵⁶ .
29 June 2022	The government decided to develop the Budhi Gandaki Hydro project using a company model ²⁵⁷ .
3 April 2023	Since the Budhi Gandaki Hydropower company couldn't progress with the construction work, the project has been turned around and it has been prepared to move forward to give the majority share ownership of the NEA ²⁵⁸ .

Pokhara International Airport: Landmark of Chinese engagement

Beginnings

As early as 1975, the GoN had decided to build a modern airport in Pokhara and acquired 3,106 ropanis of land at its current location in Kundahar, on the outskirts of the town, after DIWI, a German consultancy, selected the site and prepared a master plan for the airport in 1971. The German firm had been roped in as part of an ADB project at the time²⁵⁹. In 1989, the Japanese aid agency JICA prepared a detailed report, in which it outlined a 2,500-metre-long runway, a terminal building and a cargo building. At the time, the airport's cost was estimated to be USD 40 million²⁶⁰. The project languished under political instability of the 1990s, Nepal's decade-long civil war and as Pokhara KIs allege, the lobbying by Kathmandu's hotel operators against the modern airport in Pokhara, who viewed the project as a competitor to their businesses.

The project gained traction only in the first decade of the 21st century, when Nepal became a republic. A KI long associated with the Finance Ministry said the project was revived when the China EXIM Bank signed a MoU with Nepal in 2009 for a USD 200 million loan for infrastructure projects²⁶¹. According to the KI, Sharat Singh Bhandari, who was tourism minister then, suggested PIA as one of the projects under which the proposed loan could be utilized. The KI said at the time the project was not envisaged as an international airport but a regional one, which was also confirmed by KIIs associated with CAAN, Nepal's civil aviation authority.

In September 2011, two Maoist ministers – then finance minister Barsaman Pun 'Ananta' and energy minister Post Bahadur Bogati – committed to hand over engineering and construction of the airport to China CAMC Engineering Co. Ltd without any formal government approval to do so. The memorandum of understanding, which stated that 'GoN shall provide CAMC solid and substantial support' towards winning the tender that CAAN would eventually call for the airport, was signed between Pun and Lui Shengcheng, regional general manager of China CAMC Engineering. Bogati and then Chinese ambassador to Nepal Yang Houlan signed the MoU as witnesses²⁶².

A Pokhara entrepreneur KI who had lobbied for the airport said when he informed Chinese ambassador Yang Houlan at the time itself that Nepal may not be able to afford the project costs, the ambassador had told him China had offered a 25 percent interest-free loan and 75 percent soft loan because Nepal had a history of disregarding projects that had been built on grants. The ambassador had assured the KI that the interest-free loan component would be converted into a grant at an opportune time in the near future, and that China was positive on the issue, but that GoN would have to approach China on the matter.

The ambassador also told the KI that Prachanda had been instrumental in taking the PIA project further.

Subsequent to the unauthorized MoU signed with CAMC, Nepal's Finance Ministry asked CAAN to invite bids for the project while moving ahead with funding modalities with China's EXIM Bank. The KI associated with the Finance Ministry said they had informed Finance Minister Pun that the project would not go ahead as the Chinese government itself would reject such unauthorized MoUs. The MoU was eventually leaked in Parliament, where the Public Accounts Committee called officials from the Tourism Ministry and CAAN to explain how such a lapse of procedure was entertained. The PAC also emphasized the fact that CAAN's open bid had a very short deadline. Even the CIAA, the GoN's anti-graft body, had called for the details of the MoU citing irregularities²⁶³. Although Finance Minister Pun said the MoU had been cancelled, CAAN had invited bids for the project in February 2012. A further controversy arose when China EXIM Bank informed CAAN that it would only allow developers endorsed by it to build the airport. A news report quoted a CAAN official saying 22 firms had purchased the bid documents, but only nine had returned them. "The issue was still complicated as there were other bidders who were not in China EXIM Bank's list. Later, six bidders disappeared. The top three were all from the bank's list"²⁶⁴. The role of the Chinese Embassy in Kathmandu in facilitating the deal towards the Chinese bidders has been confirmed by various KIs, amid allegations.

GoN had initially estimated the project would cost around USD 166 million²⁶⁵. A KI from the Finance Ministry said a Japanese estimate was closer to USD 137 million, and even an initial estimate by CAMC itself was around USD 200 million. The KI informed that they had opposed the PIA project because of four reasons – namely, Pokhara's vulnerable geography, high costs, reduced tourist value and the fact that long-haul aircraft would not be able to land due to the short runway. But the prime minister at the time, Maoist leader Baburam Bhattarai, forced them to acquiesce and even insulted them. The KI also said they had received personal threats and was subjected to a coordinated campaign against them.

In July 2012, when the bids by three shortlisted Chinese companies were opened, the lowest bid had come from CAMC at USD 305 million, almost USD 120 million more than GoN's estimates. The other two shortlisted bidders – Sinohydro and China International Water and Electric Corporation – quoted USD 337.82 million and USD 349.28 million respectively²⁶⁶. Almost immediately, Nepali parliamentarians and officials grew suspicious, with then MP Deep Kumar Upadhyay saying in a press conference that Chinese companies had been selected to build the airport without any transparency.

The project stalled, and Maoist leader Bogati defended the selection of Chinese contractors as part of a bilateral dialogue²⁶⁷. Another KI formerly with the Planning Commission said they were not aware how the costs could have risen so high from the estimate. “Maoist politicians were so aggressive and denounced all of us who questioned the cost inflation,” he said, adding that “there were enough reasons to suspect corruption in the deal.” Several local KIs also said CAAN was against building an airport in Pokhara. A CAAN official and KI said it was true that CAAN had originally envisaged a regional airport operating short-haul flights and not an international one that could handle long-haul flights. But it was only after the agreement with China was finalized that more land was acquired and it was decided to turn it into an international airport. An additional 500 ropanis was acquired for the airport, which saw disputes over the land prices, but it was resolved after the government increased the compensation sum²⁶⁸. The land for the airport was acquired in seven stages, with the seventh stage of acquisition taking place in 2019²⁶⁹. A CAAN official and KI said Nepal had spent at least NPR 5 billion on land acquisitions.

Meanwhile, local sentiment began to be mobilized. While Pokhara locals had long been lobbying for an airport in their town, it is alleged that both the UML and the Maoist parties took advantage of local sentiment to swing public opinion in favour of the project, despite the lack of transparency around the deal and the high costs. In August 2012, local protestors shut down the domestic airport in Pokhara demanding the PIA project to be initiated soon²⁷⁰. In January 2013, CAMC itself wrote to the Civil Aviation Ministry saying it was willing to build the airport at the government-estimated costs. A three-member panel then estimated the costs to be around USD 220 million, but the project was not prioritized by the interim government led by former Chief Justice Khil Raj Regmi. However, the delay faced by the project saw Pokhara locals initiating a more-than-100-day-long relay hunger strike, which witnessed wide participation from all sections of Pokhara. The Pokhara entrepreneur KI said they had engaged all political parties, and almost all professional and civil organisations to build pressure on the government. “We took 500 vehicles full of people to Kathmandu,” they said. Then Finance Minister Ram Sharan Mahat also alleged that the cost estimates for PIA were unrealistic and outrageous compared to the costs of Gautam Buddha International Airport (GBIA) being developed in Bhairahawa at the same time²⁷¹. A Pokhara KI alleged that Mahat had not been in favour of the project, but had to back down after local pressure.

Loan negotiation and agreement

In April 2014, CAAN and then Tourism Minister Bhim Acharya of the Nepali Congress approved the project at a revised cost of USD 215.96 million. CAAN had earlier submitted a separate proposal to the Tourism Ministry asking it to request China to convert the loan pledged by EXIM Bank towards the airport into a grant²⁷². In May

2014, CAAN Director General Ratish Chandra Lal Suman and CAMC chairman Lou Yan signed a deal worth the revised cost, despite the CAAN Director General earlier saying he was not comfortable signing the deal in such contentious circumstances²⁷³. The modality of project was also changed from a Bill of Quantity (BoQ) to the original EPC model after a ministerial decision to enforce the revised cost estimate. The deal agreed that CAMC would conduct a detailed design of the project once the loan was sanctioned. Participants during the Focused Group Discussion (FGD) at Pokhara alleged that CAMC had initially agreed to discuss the designs with local stakeholders as well, but it had not been forthcoming. CAMC was also asked to be more transparent with local stakeholders once the construction began, which it did not do.

By January 2016, loan negotiations had been concluded with China EXIM Bank, and in April 2016, Oli laid the foundation stone for the airport after completing the loan agreement with the bank during his state visit to China in March. The loan terms for the USD 215.96 million project were as follows: 25 percent interest-free concessionary loan, with a grace period of seven years and a maturity period of 20 years; 75 percent sum charged at 2 percent interest, seven years grace period, and 20 years maturity²⁷⁴. The Ministry of Finance (MoF) in turn initiated a subsidiary loan agreement (SLA) with CAAN, where it lent out the sum to the aviation authority at 5 percent interest, and other terms remaining the same, with the MoF agreeing to bear foreign exchange risk itself²⁷⁵. One interpretation of this SLA is that because of the higher interest rate, CAAN will have to pay MoF the interest from its earnings elsewhere and not just the PIA²⁷⁶.

A subsequent controversy arose when the EXIM Bank put up the condition that CAAN will have to open a joint escrow account and deposit its earnings from all its airports towards debt servicing in the account. However, CAAN refused to do so, which delayed the project by another year. Allegedly, the CAAN director at the time refused to open such an account²⁷⁷. In April 2017, EXIM Bank amended the condition so that CAAN would have to deposit only the earnings from PIA into the escrow account²⁷⁸. However, the CAAN director was suspended from his post despite the amendment, one of the reasons for the suspension being the delay in construction of PIA²⁷⁹. In August 2017, CAMC began construction, with locals noting that the city authorities needed to focus on upgrading the road approach to the new airport. CAAN authorities also notified that the paragliding adventure sport industry would have to be shifted to a new location due to the PIA, and directed local authorities to take appropriate measures²⁸⁰. Local KIs also said Pokhara municipality was aware of the fact that a nearby landfill site would have to be moved as well, and that a small hill to the east of the airport – Rithepani Danda – would have to be cut down for the runway approach. However, permission for the latter was given only in March 2021 after a delay of several months²⁸¹. By March 2022, the hill still hadn't

been flattened, despite CAMC getting ready to test the communications and navigation equipment²⁸².

Local KIs also said both CAAN officials and local authorities knew that drainage was an issue during the monsoon months, and a water tank built by JICA to the west also needed to be shifted. But all of these issues lingered, in some cases even after the airport was inaugurated in January 2023.

Concerns on the cost of PIA

The relatively high cost of the PIA – as opposed to the GBIA – had been questioned at the time. One news report quoted an official saying at least NPR 6-7 billion had been paid off as kickbacks and commissions, although there was no evidence to verify this²⁸³. The same official also alleged in the report that Chinese officials had agreed to increase the loan sum in December 2017, and in turn, some lobbyists had begun to lobby for the addition of some components in the parking bay. Local KIs, however, downplay the costs of the airport, with many agreeing that the airport was a necessity, but only China had come forward to fund it, so they had to make do with what they were offered. As one KI said, “In the case of infrastructure for public benefit, the state and the public should not expect profits.” The KII emphasized that none of the multilateral institutions such as WB or ADB had considered the project a priority, nor did other bilateral institutions such as JICA.

Dr Zhao Liang of China EXIM Bank’s Sovereign Business Department (Concessional Loan Department) and country manager for Nepal and Sri Lanka noted that Nepali negotiators were tough and unblinking. “On the day of the negotiation, the Nepali side deliberately selected personnel from different departments to form an ad hoc committee... Although the members have their own professional knowledge, they obviously have no understanding of China's loan business and process... On the second day, the committee members began to negotiate on the loan conditions, loan process and even the specific content of the agreement. The negotiation process was extremely difficult, partly because some committee members had too strong a "Nepalese English accent", and sometimes had to ask to repeat it, or other committee members relayed it”²⁸⁴.

In June 2018, as construction of PIA was underway, a 21-member team led by a former secretary submitted a report that said PIA was unfit to operate international flights²⁸⁵. By April 2019, the construction of the runway and apron works had been completed. In November 2019, it was announced that PIA would incorporate a wide-area multilateration system that improved radar coverage and was “accurate and reliable”²⁸⁶. However, the Covid-19 pandemic slowed down the construction, with 60 percent completion reported by July 2020. The deadline was extended to April 2022 in August 2021 citing Covid-19

related delays; the original deadline was July 2021, but CAMC was on track to finish the airport six months before the deadline²⁸⁷.

In March 2022, during Chinese foreign minister Wang Yi's Nepal visit, he conducted a symbolic handover of the airport to his Nepali counterpart Dr Narayan Khadka. Ninety-three percent of the work had been completed by then²⁸⁸. However, questions were raised as to whether China had handed over the airport to Nepal in haste, with several aforementioned hurdles to successful flight operations – clearance of the landfill site, flattening the hill, and the drainage facilities around the airport – not resolved yet²⁸⁹.

Nonetheless, in August 2022, CAAN announced that the new airport would be inaugurated on 1 January 2023, despite the landfill site proving to be a flight hazard due to the many birds of prey that the landfill site attracted²⁹⁰. Although PIA and CAAN officials were quick to assure that the work would be completed before the inauguration, Pokhara municipality officials acknowledged they were running late with the relocation of the landfill site²⁹¹. The calibration flight originally scheduled for October 2022 was postponed to November because the hill to the east hadn't been flattened yet²⁹².

A day before the airport was to be inaugurated, the Chinese Embassy in Nepal released a statement saying the PIA was the “flagship project” of Nepal-China BRI cooperation, thus including the airport within its BRI framework. However, Nepali officials immediately denied the airport was part of the BRI²⁹³. Nepali officials believe since the PIA negotiations were concluded before Nepal signed up to the BRI, PIA is not a part of BRI. China's preference for a unified Communist government in Nepal was also witnessed with the formation of a new government headed by Prachanda and supported by Oli after the November 2020 general election. The embassy immediately announced the opening of the land border routes which were closed for two years owing to the Covid-19 crisis, and a six-member Chinese delegation from the China Railway First Survey and Design Institute Group landed in Kathmandu a day after government formation to carry out a feasibility study on the Kerung-Kathmandu railway²⁹⁴. China was also quick to congratulate Prachanda, emphasizing on expansion of the BRI framework during its foreign ministry's spokesperson's remarks²⁹⁵. However, multiple KIs indicated Prachanda was not too pleased with the Embassy for including PIA under the BRI umbrella since he was not keen on being seen as a pro-China prime minister in his third term.

Operationalization

The airport was inaugurated on 1 January 2023, with a massive crowd gathering at the airport. Two flights – one by Buddha Air, the other by Himalaya Airlines – landed at the new runway with Nepali and Chinese officials present. The CAAN Director General

allegedly forced the A320 aircraft of Himalaya Airlines to carry out a demonstration flight under visual flight rules (VFR), since the instrument landing system (ILS) was to be installed only by late February. The Himalaya Airlines aircraft was supposedly meant to be carrying the Prime Minister as a way of showing the airport was fully functional, but airline officials refused to do so²⁹⁶.

Several KIs from Pokhara said they had insisted the new airport only be inaugurated by initiating international flights, but they were told there was ‘pressure from above’ to inaugurate the airport soon. The KIs also said CAAN officials had promised them that international flights would start from the airport within two weeks, which did not happen. That the airport was inaugurated in haste is confirmed by the fact that the government decided to set up a customs office at the new airport only a week after its inauguration²⁹⁷. Pokhara locals have also been negotiating an expansion of the runway to 3,000 metres in order for longer-haul aircraft to operate out of PIA. However, to do so, PIA authorities will need to clear out a school and a newly built water tank to the west of the current site.

Two weeks later, on 15 January 2023, a Yeti Airlines flight carrying 72 passengers and crew crashed while landing at the PIA. All were declared dead. The aircraft had initially been given clearance to land from the East-West approach, but its pilots asked for permission to land from the West-East approach. Preliminary investigations have revealed feathered propellers resulting in the loss of thrust leading to the crash²⁹⁸. The crash was a shock not just because there were no weather disturbances or other issues that could have led to the crash, but also because it came within two weeks of inauguration. In February 2023, a social media video showed a Buddha Air aircraft colliding with two birds of prey while landing at the airport, raising new concerns about safety²⁹⁹.

A further news report then stated that even narrow-body jets such as Airbus A320 will face payload issues due to technical shortcomings at the PIA³⁰⁰. CAAN officials and pilots reportedly told the newspaper that preliminary reports suggested an A320 taking off from Pokhara would only be allowed to carry a maximum load of 68 tonnes as opposed to a full load of 72 tonnes, which would prevent such narrow-body jets from flying to and from PIA at full capacity. This would apply to flights longer than 90 minutes, meaning airlines would have to either incur a loss or charge higher fares while flying to and from Pokhara. The PIA also does not allow a 180-degree turn since it has a single-runway approach system, thus any narrow-body aircraft approaching it must land from the eastern approach³⁰¹. CAAN officials agreed that taking off from PIA is not as difficult as landing is, but these issues were already known before construction. Reports have questioned CAAN's commitment to rectifying air safety measures and instead prioritising new terminal and airport contracts³⁰².

Although an Instrument Flight Rules (IFR) system was installed at PIA in February, no international flights have yet been conducted from the airport. The airport continues to serve as a new domestic airport, with the old domestic airport now lying empty. At the FGD with local stakeholders, it was clear that Pokhara locals were worried at the state of affairs and agreed that the inauguration and other technical details of PIA had not been planned properly. India has not given permission to any airline to fly to PIA, which could be seen as another indication of Delhi denying market access to Chinese investments in Nepal. Pokhara KIs suggested there could have been ulterior political motives behind the inauguration of the airport and asked whether the airport had been inaugurated too early. The access road to the airport is part of the Mugling-Pokhara highway expansion project under the ADB, but no work has been initiated on it. Although KIs from Pokhara continue to allege that there is a larger conspiracy afoot to create a negative perception around the PIA, they are clear that the airport was a result of local efforts and sustained pressure. “There was common consensus that the first flight to the new airport should have been an international flight,” a KI long associated with the tourism industry in Pokhara said. The same KI also alleged that the calibration flight conducted by Aero Thai was not transparent, and that CAAN decided to open up the airport on the basis of its summary report alone. Another KI at Pokhara said, “We were swept away by the PIA wave, but where is the accompanying infrastructure?”

Key issues

Several issues emerge from the decade-long story of PIA. The first is that of collusion between Nepali government officials and politicians in forwarding the deal with CAMC, as seen in the fact that an informal MoU had been signed with the company by office holders in Kathmandu even before any funding modalities were discussed. Further, the same company received the EPC contract even after a non-transparent bidding conducted by CAAN. This suggests CAMC had, in the tradition of other Chinese SOEs, already negotiated the contract for the PIA and then convinced China EXIM Bank to fund the project. Similarly, the fact that Maoist ministers signed an informal MoU with CAMC without a proper procurement process also suggests high level of collusion, and UML leaders pushing the airport agenda suggests both UML and the Maoist Party had colluded in pushing forward the agenda. While it is difficult to prove direct corruption without a paper trail, the fact that the winning bid was initially almost 85 percent more than the GoN’s estimate, and subsequently CAMC decided to build the airport at the reduced estimate of USD 215 million also suggests the costs of construction – and debt burden – could have been higher had the matter not been raised by other parties.

However, what must be emphasized is that PIA was built on the back of sustained pressure from Pokhara locals cutting across party ideologies and organisations. While it may be

said that Nepal's political leaders – particularly those of the Left – took advantage of local demands to push forward the PIA agenda, it must be noted that all Pokhara KIs we spoke to said building the airport was the right decision, and that despite the debt servicing ahead, infrastructure projects must not be looked at from the profitability factor alone. There is an argument to be made here about how local pressure can allow politicians and government officials to create a positive public opinion that allows them to get away with opaque and financially unstable infrastructure projects. As a KI with a private research group said, “Did the Chinese create the demand for PIA? Or was it a political demand that was created and China acted on it? Or did the Chinese contractor and Nepali politicians come together to create that demand and secure the finance? There is a very thin line.”

The fact remains that the PIA is suffering from several foundational weaknesses that should have been scrutinized by CAAN and other authorities before and during construction. Similarly, the fact that the airport is facing several technical and engineering related issues means CAMC's designs for the airport were not scrutinized by CAAN.

What is also clear is the key role the Chinese Embassy played to move the deal ahead. The Embassy also earmarked the airport as part of BRI, thus signalling a larger geopolitical motive behind the airport that was not necessarily displayed during its construction. There are suggestions that China labelled the airport as a BRI project because of the critique it was receiving around BRI projects not taking off in Nepal. India's unwillingness to allow airlines to fly to and from PIA may have to do with its hesitation with allowing Indian market access to Chinese investments, but Nepal's weak economic diplomacy has been on display at PIA, especially since Chinese airlines have also refused to fly to the airport so far.

Further, the saga around the PIA contract – with the transfer of key officials and the collusion of others – is also reflective of how corruption persists in Nepal. If a government official does not agree to move ahead on a deal, they will be transferred or suspended. The lack of planning and coordination around the airport, and the safety issues such as clearance of the landfill site, both during and after its inauguration suggests a wilful disregard towards passenger safety issues. CAAN officials also changed pilot rules after the Yeti Airlines crash, but it was evident that the pilot was allowed to test a new approach path with passengers on board, which should not have been cleared by the air traffic control officials³⁰³. This points to a foundational weakness in CAAN, in that it is both the regulator as well as a service provider, which has been one of the key reasons outlined by the EU in its ban on Nepali airlines flying to European destinations³⁰⁴. However, CAAN continues to reject the separation of its two roles as outlined by the EU as essential to it taking Nepali airlines off the air safety list.

The PIA is, in fact, the only Chinese investment in Nepali infrastructure that can be termed as following the norms of Chinese BRI investment elsewhere in the world. It has been designed and built by a Chinese contractor on an EPC model, using China EXIM bank funds at both concessionary and interest loans, and built on the back of a government-to-government bilateral deal between the two parties. It is also a clear example of how Chinese SOEs operate across the world, first by identifying the project and negotiating its modalities with the host government, then securing the financing through China EXIM Bank or other Chinese funding sources, and building on an EPC model that requires the host country to pay back the loan. The maturity period of the loan at 20 years is also comparable to other Chinese-funded projects elsewhere. As such, while the Chinese Embassy labelling it as a flagship BRI project in Nepal may not be technically true from the Nepali perspective, in all other aspects, it resembles BRI projects elsewhere in South Asia and the world. The key now will be for Nepal to operationalize it successfully. Nepal will have to start paying back the interest from March 2023, and although there are no immediate fears of Nepal's inability to service the debt, PIA's continued non-operationalization will result in Nepal having to dip into other resources to pay back the monies.

Pokhara International Airport Timeline

Date	Events
1971	DIWI prepared a masterplan for Pokhara International Airport ³⁰⁵ .
1975	To develop the airport at Savik Chhinedanda, the government purchased 3,106 ropanies of land ³⁰⁶ .
1988	The Pokhara Airport Master Plan created by DIWI was reviewed by JICA. JICA suggested breaking the project up into two phases. The initial phase would run from 1995 to 2000 and would cost an estimated USD 40 million. The estimated cost of the second phase, which would run from 2001 to 2010, was USD 45 million ³⁰⁷ .
1993	Department of Civil Aviation completed a detailed engineering survey ³⁰⁸ .
2008	Joshi Associates prepared a concept paper for turning a new Pokhara airport into a regional international airport ³⁰⁹ .
2010	Joshi Associates conducted the Detailed Engineering Survey, prepared the Layout Plan and estimated the Earthwork of the proposed Regional International Airport at Pokhara ³¹⁰ .

20 September 2011	The Ministry of Energy signed a clandestine agreement with CAMC, wherein it was mentioned that the tender would be invited later, and for that “the government of Nepal will provide concrete and adequate support to CAMC” ³¹¹ .
14 January 2012	During his visit to Nepal, Chinese Premier Wen Jiabao announced an aid worth USD 750 million, which included loan facilities for the development of the Pokhara airport ³¹² .
2012	The appointment of Ganesh Raj Joshi as Secretary at the Ministry of Tourism and Civil Aviation by the Bhattarai-led government sparked controversy due to his decision to award contracts to a Chinese company for the airport ³¹³ .
22 May 2014	Ratish Chandra Lal Suman, the director general of the Civil Aviation Authority of Nepal (CAAN), and Luo Yan, the chairman of China CAMC Engineering Co. Ltd., signed a contract for the construction using the EPC model. The contract was worth USD 215.96 million ³¹⁴ .
January 2015	Environment Impact Assessment was submitted by CAAN to GoN ³¹⁵ .
21 March 2016	A loan agreement worth RMB 1.37 billion was signed between the Government of Nepal and Government of China ³¹⁶ .
13 April 2016	The PIA's foundation stone was laid by Prime Minister KP Sharma Oli in Chhinedanda in Pokhara Sub-Metropolitan City ³¹⁷ .
5 June 2016	The loan agreement proceeds were utilized by the Government of Nepal to provide funds to the CAAN. The loan carries a 5% interest rate, a maturity period of 20 years, and a grace period of 7 years ³¹⁸ .
31 May 2017	The EXIM Bank of China approved the loan, and CAAN was obliged to deposit PRIA's revenue into an escrow account ³¹⁹ .
11 July 2017	A letter to proceed with construction was issued to China CAMC Engineering Co. Ltd. ³²⁰
25 February 2018	The construction work started after the GoN, the CAAN, and the Chinese Exim Bank secured financial resources for the construction of the airport ³²¹ .
22 August 2018	The construction of PIA's new terminal was inaugurated by Rabindra Adhikari, Minister of Culture, Tourism, and Civil Aviation (MoCTCA) ³²² .

17 April 2019	Completion of the PIA's runway has completed, and with it, 35% of the project's construction ³²³ .
2 July 2019	Chinese contractor Zhu Ngfen engaged in the construction of the PIA killed a 38-year-old Nepali citizen at Amar Singh Chowk in Pokhara ^{324,325} .
14 December 2019	Government decision to acquire 148 ropani of land for PIA angered the locals and protest started indicating the government's inability to acquire land all at once ³²⁶ .
14 June 2020	Despite the key equipment being stranded in the Chinese and Indian borders due to Covid-19 lockdown, construction of PIA is on track.
29 December 2020	52 Chinese workers returned to work after being inoculated with Covid-19 vaccine.
4 March 2021	The government through a cabinet meeting gave CAAN the permission to flatten the Rithepani hill after conduction a supplementary EIA ³²⁷ .
9 July	Covid-19 pushed the PRIA completion back as the construction has stopped.
August 2021	CAAN gave a one-year extension to complete the PIA project ³²⁸ .
26 March 2022	During his visit to Nepal, Wang Yi, the Foreign Affairs Minister of the People's Republic of China, handed PIA to the GoN ³²⁹ . 93% of the physical work had been finished by the time of handover, and the construction company would continue working until the project's full completion ³³⁰ .
27 November 2022	Over the course of a week, from November 21 to November 27, the aircraft of Thailand's Aero Thai Company completed a calibration flight at PIA ³³¹ .
31 December 2022	Twitter handle of Spokesperson of Chinese Embassy in Nepal stated PIA as a flagship project of China-Nepal BRI cooperation ³³² .
1 January 2023	PIA was inaugurated by Prime Minister Puspha Kamal Dahal ³³³ .

Kathmandu Ring Road Expansion Project

In March 1973, an agreement was signed in Kathmandu between China and Nepal, in which China committed to construct a ring road around the Kathmandu valley. The 30-km long road was estimated to cost USD 4.95 million and would link the Indian-built Tribhuvan Highway and the Chinese-built Kodari Highway, providing a solution to the increasing traffic problem in the capital. The road was designed to have seven major bridges and several culverts, passing through major points like Bansbari, Gangabu, Swayambhu, Naikap, Tribhuvan University Campus area, Jawalakhel, Satdobato, Koteshwor, and the Tribhuvan airport. In 1977, the construction of the road was completed offering a significant advantage to the transportation system in the valley and also signifying China-Nepal relationship³³⁴.

The Kathmandu valley experienced access and mobility issues as a result of the enormous population growth from the 2000s onwards. In 2011, China agreed to provide an assistance worth USD 40 million for the first stage of expansion and upgradation of the Ring Road³³⁵. The agreement included maintenance of the main road stream bridges, building a new relief road stream bridge, building one urban flyover, and construction of three pedestrian overpasses in addition to widening the 27-kilometer stretch of four-lane, two-way roads around Kathmandu to eight lanes with a two-way bicycle lane and pedestrian pathway.

The expansion of the ring road was to be in three stages, with the first stage consisting of the construction of the new Kalanki Bridge intersection and the 10.5 km Kalanki-Koteshwor portion. The design consultant was Third Railway Survey and Design Institute Group Corporation, while the contractor was Shanghai Construction Group Co Ltd. As of January 11, 2023, the Chinese Government had paid out USD 33,154,069 for this project, according to the Aid Management Information System (AMIS) of the GoN³³⁶. This project was initiated on June 25, 2013 and it was completed on December 15, 2018³³⁷. It was formally handed over to the Nepali authorities on February, 2019³³⁸.

Initially, the Chinese government stated that construction Kathmandu Ring-Road Second Phase (Kalanki–Maharajgunj) would start in the early 2020³³⁹. However, Nepal has not received an English version of the already-prepared DPR by the Chinese side³⁴⁰. Construction was expected to start in the early 2020s, but the Chinese side were reluctant to begin the expansion work citing various reasons such as land acquisition and clearance issues that were faced in the first phase of the expansion³⁴¹. To kickstart the road upgradation, the site had been cleared after removing electric poles and cutting down of more than 2,000 trees in 2019. The latter move saw widespread criticism from urban planners and environmentalist.

After a prolonged period of ambiguity, the second phase of expansion has been revitalized with fresh optimism after the arrival of the new Chinese ambassador, Chen Song, in early 2023. Nepal government officials, Chinese embassy representatives, and stakeholders examined the project site covering 8.2 km, between Kalanki and Maharajgunj in February 2023³⁴². Although this development has been well-received, some urban planners and cyclists are expressing apprehension that the project's implementation may mirror the first phase's pattern, which primarily raised controversies on design and safety issues.

While the upgradation of Kathmandu Ring Road Phase one had provided numerous benefits, including improved transportation links and increased economic activity, it had also created new safety challenges. Although the road expansion has been designed to meet international standards, the lack of traffic signs and signals, zebra crossings and overhead bridges, risky guardrails and open side drains pose a risk to users' safety due to Kathmandu Ring Road Phase one expansion³⁴³.

Phase one of the expansion came under severe scrutiny after public allegations of it being unsafe³⁴⁴. Public concerns about the safety of pedestrians and other road users received significant attention. To address this issue, the Nepalese government conducted a Road Safety Inspection of Kathmandu Valley in 2019 and took the initiatives to make the road safer for its users by acknowledging the recommendations given in the report.

However, some issues emerged with phase one of the expansion project. The first was that the Department of Road (DoR) agreed to the road design blueprint without any scrutiny, resulting in the safety issues as well as the fact that the DoR is now building a new flyover at one of the crossings to mitigate the traffic issues. Because the design planned the road as an expressway inside the city, it has few pedestrian facilities which is required for a city like Kathmandu, a KI said. Several accidents and casualties have been reported on the expanded phase one of the Ring Road primarily due to these issues. The safety audit conducted by the DoR termed these issues as 'serious negligence'³⁴⁵. KIs also said the safety audit was conducted by the DoR only after the safety issues were reported in the press. A journalist KI said despite repeated attempts to contact the Chinese contractors, the latter refused to talk to the press.

Chinese contractors in Nepal's infrastructure outside of bilateral mechanisms

So far, this report has highlighted China and/or its companies' bilateral engagement with Nepal in the infrastructure sector. However, increasingly, Chinese companies – mostly state-owned enterprises, and a few private sector enterprises – are involved in acquiring

infrastructure contracts awarded by multilateral institutions such as the ADB, infrastructure contracts awarded by the Nepali government and/or its institutions such as the Nepal Army, and contracts awarded by private sector institutions, particularly in the hydropower sector. Chinese companies have also significantly expanded their engagement in Nepal, mostly through joint venture consortiums with Nepali companies in the energy sector. This section will define Chinese contractors in the Nepali infrastructure space outside of bilateral mechanisms, and will be divided under three heads:

- 1) Chinese contractors in multilateral institution-funded infrastructure projects, primarily ADB's contracts in road and aviation sectors
- 2) Chinese contractors awarded infrastructure contracts by Nepal government and/or its institutions
- 3) Chinese private sector engagement in the infrastructure sector

Because of the nature of contractual engagements, it is often assumed that such engagements can be described as part of Chinese overseas investments, whereas in reality, they are not. Instead, they must be viewed primarily from a business opportunity lens and as a service export. Chinese overseas contracts surpass Chinese FDI globally, and '[w]hile the largest destinations of Chinese Outward Foreign Direct Investment (OFDI) are advanced economies, the leading markets of China's international contracting are all developing countries'³⁴⁶. Much of this expansion has been seen since 2000, when China's State Council issued a directive that all Chinese state organs must develop international contracting in order 'to help promote our exports and accelerate our transition toward a trading superpower from merely a large trading nation; it will facilitate the utilisation of both domestic and overseas resources and markets, transferring abroad surplus engineering capacity from home; it will help our enterprises to "go out" and integrate into economic globalisation, cultivate our own multinational corporations and enhance our international competitiveness; it will help improve our political and economic relations with foreign countries, especially relations with developing countries'³⁴⁷.

As a result, since 2000, Chinese construction companies have increasingly expanded their overseas footprint. By 2018, 75 of the world's top 250 international contracting firms were Chinese, with 24.4 percent of the world's contract revenues going to Chinese companies³⁴⁸. In 2022, 15 out of the top 20 global contractors were Chinese³⁴⁹. Chinese companies signed 12,000 international contracts in 2019 from 6,000 in 2004. In 2019, Chinese companies won USD 260.3 billion worth of global infrastructure contracts. In 62 BRI countries, Chinese companies obtained approximately 60 percent of new contracts amounting to USD 154.9 billion³⁵⁰. A majority of such contracts were secured in African

and Asian countries, with China becoming the largest player in Africa by 2006³⁵¹. Chinese contractors are also organized under the China International Contractors Association (CHINCA), which has over 1,300 member-companies³⁵². Their importance also lies in the fact that Chinese contractors often initiate projects on their own with host countries – as seen with China CAMC Engineering in the PIA project in Nepal, and provide the momentum for China’s EXIM Bank and Development Bank to fund the project. ‘Although the borrower in both foreign aid concessional loans and [preferential buyers’ export credits] is technically the government of the host country, it is the Chinese [international contractors] eyeing the contract that drive the borrowing process’³⁵³.

While accurate figures for Chinese contractors and/or their investments in the infrastructure sector in Nepal are not available, they have begun to play an important role since 2008, when China began to expand its political footprint in the country. Such trend also highlights the synergy between China’s political expansion and its economic engagement in a host country, suggesting China’s increasing political engagement resulting in new economic opportunities for its companies. Furthermore, since Nepal’s infrastructure contracts are relatively lower in monetary value and the procurement laws prescribe the lowest bid procurement award, the international competitive bidding (ICB) process initiated by multilateral institutions such as the ADB and the Nepal government itself are usually targeted by companies from neighbouring countries such as India and China who can bid lower than companies from other countries. As a KI formerly associated with a multilateral institution said, ICB is often reduced to being termed as ‘India China bidding’. Similarly, contrary to expectations about the quick pace of Chinese contractors, most contracts undertaken by Chinese companies in Nepal, especially in the road and transport sector, have been plagued by delays.

Chinese contractors in multilateral-funded infrastructure contracts

Roads and Highways

Mugling-Pokhara Highway Expansion

As a part of the 10-year South Asian Subregional Economic Cooperation Programme, to boost regional connectivity through economic corridors, trade and energy security³⁵⁴, ADB funded the expansion of the Prithvi Highway between Mugling and Pokhara. The loan amount of USD 195 million was approved in October 2019, with the GoN providing USD 59 million for the total project cost of USD 254 million. The currently two-lane highway was first built by China in the 1970s, and handles about 7,400 vehicles a day. The project has been divided into two phases, with Phase 1 of the project a stretch of 81 km between Anbukhairani and Pokhara currently underway. Feasibility and design studies are currently

ongoing for Phase 2 of the project, which is a stretch of 8 km between Anbukhairani and Mugling, due to difficult terrain and the presence of a hydropower plant³⁵⁵.

The project envisages widening the current two-lane highway into a four-lane highway with safety features such as crash barriers. The Ministry of Physical Infrastructure and Transport and the Department of Roads are the executing agency and the implementing agency for the project. The 81-km-long Phase 1 of the project has been divided into two sections and contracted out accordingly. Contracts for both sections were awarded to Chinese companies. China Communication Construction Company Ltd was awarded the contract to upgrade the 41.45-kilometer stretch from Anbukhairani to Jamune, while the 39-kilometre western section from Jamune to Pokhara has been given to Anhui Kaiyuan Highway and Bridge Company³⁵⁶. The contractors will also be responsible to maintain the highway for five years after completion³⁵⁷.

The project is intended to be completed by April 2024. However, the progress rate has been slow. By December 2022, according to ADB, China Communication Construction had shown only 11.39 percent physical progress, while Anhui Kaiyuan had completed only 3.04 percent of the works. In total, only 7.21 percent progress was reported by December 2022³⁵⁸. Pokhara city authorities and locals have expressed discontent at the slow pace of progress. The chief minister of Gandaki province, Khagaraj Adhikari, alleged that the contractors had agreed to expand five km of the highway before moving on to the next five km stretch, and to build an access road parallel during the expansion to ease traffic. However, the contractors have not done so, the chief minister told Pokhara tourism professionals – “If necessary, I am in favour of terminating the contract and selecting a new contractor”³⁵⁹.

The highway expansion project has been critiqued for not taking adequate steps to mitigate the resultant dust and air pollution during its construction, with locals from a town near the highway even locking up contractor staff for their failure to reduce the dust pollution³⁶⁰. The Environmental Impact Assessment had recommended monitoring air pollution during the construction, but no such steps have been taken. Almost 7,000 trees have been cut down for the expansion project³⁶¹.

Narayanghat-Butwal East-West Highway Expansion

The ADB approved a loan of USD 186.8 million in December 2016 to upgrade the 115-km-long Narayanghat-Butwal stretch of the East-West Highway and a 45-km-long feeder road from Bhairahawa to Taulihawa, with the total project cost estimated at USD 256.5 million and GoN contributing USD 69.7 million³⁶². The contract was divided into

two packages, with China State Construction acquiring the Narayanghat-Butwal highway expansion, while Indian construction company Gawar Construction Limited acquired the contract for the feeder road in June 2017³⁶³.

The Department of Roads had to scrap the first package's contract process in 2018 after ADB disqualified the lowest bidder citing technical reasons. Twenty-five companies from China, India and Italy had participated in the ICB issued in 2017, and three companies were finally shortlisted. According to a DoR official, one company was disqualified by ADB due to technical reasons, while the financial status of another company did not allow the DoR to enter into an agreement with them. The third company quoted a bid amount that was much lower than the project cost, forcing the DoR to scrap the entire process and reissue a tender³⁶⁴.

The contract for the Narayanghat-Butwal highway expansion package was then awarded to China State Construction Engineering Corporation Ltd in December 2018 for both sections of the package, and then Prime Minister K.P. Oli even laid the foundation stone for the expansion project in April that year. But the project was once again held up due to a faulty EIA assessment. A 2016 EIA had said 9,027 trees needed to be cut down for the expansion. But a secondary assessment said at least 50,352 trees need to be felled³⁶⁵. Approval was then required from the Department of Forests for the felling of around 4,000 trees that lay within the boundaries of Chitwan National Park, but the department delayed its approval despite the trees being felled³⁶⁶. As 24 km of the highway falls under the buffer zone of Chitwan National Park, five wildlife underpasses have been proposed to be built during the expansion.

Similarly, almost 4,840 electricity poles – carrying transmission lines of 132 KV, 33 KV and 11 KV – would need to be shifted at a cost of NPR 750 million before the road expansion works could begin³⁶⁷. Finally, China State Construction began working on the project in October 2019. Work stopped almost immediately due to the Covid-19 pandemic. By September 2021, only 8 percent physical progress was reported³⁶⁸. China State Construction had begun to lobby for an extension of the contract, although the DoR alleged the delay was due to negligence on part of the contractor³⁶⁹. DoR engineers had requested the contractor to speed up work, but China State Construction was found to be 'very unresponsive' to the request³⁷⁰.

The expansion project continued to move at snail's pace, with 17 percent progress reported in May 2022, two months away from the original deadline³⁷¹. China State Construction asked for a two-year extension, with a revised completion date of July 2024. In September 2022, the DoR issued a notice to China State Construction stating continued failure to

complete the project would result in contract termination. “We have closely monitored your work progress since September 2021 until today and you have fallen far behind the target,” the notice states. “Furthermore, there are no substantial work activities at the site. Also, there are no sound preparations to convince the engineers and the employer that the contractor will expedite the work and complete the project on time”³⁷². The notice also said the contractor had ‘ignored numerous instructions by engineers and the employer; the road surface was littered with myriads of potholes, causing discomfort to the users, besides causing dust nuisance that posed health hazards and contributed to road accidents’³⁷³.

However, the DoR decided to continue with the contractor in November 2022 after seeing ‘visible progress’ on the project. A DoR official said the contractor had carried out repair and maintenance work after the project deadline was extended, and also mobilized a larger number of workers on the project³⁷⁴. By December 2022, progress rate was reported to be 22.55 percent and 23.07 percent on the two sections of the highway expansion package, whereas the 45-km-long feeder road had been completed by the Indian contractor³⁷⁵.

The delay in the expansion project resulted in widespread media attention, with the newly appointed minister for physical infrastructure and deputy minister Narayan Kaji Shrestha, a Maoist party member, visiting the site in January 2023. But when the minister instructed the contractor that delays would no longer be acceptable and that he would personally resolve issues if any, the contractor’s representative told the minister that only 50 percent of the project would be completed within the extended deadline period³⁷⁶.

Hydropower

140 MW Tanahun Hydropower Project

The 140 MW Tanahun Hydropower Project is a reservoir-type project being developed by Tanahun Hydropower Ltd, a subsidiary of the state-owned NEA. The USD 505 million project is being funded through loans from a variety of multilateral and bilateral actors such as the ADB (USD 150 million), JICA (USD 184 million), the European Investment Bank (USD 85 million), and the Abu Dhabi Fund (USD 30 million); a USD 33.55 million grant from KfW, and the remaining sum by GoN³⁷⁷. Procurement packages were split into four packages, with package 1 covering main headworks won by Song Da-Kalika Joint Venture (JV) (a joint venture between a Vietnamese and Nepali construction company) in August 2021; package 2 covering waterway and powerhouse equipment won by China’s SinoHydro Corporation in January 2019; package 3 covering power transmission lines won by India’s Kamani Engineering Corporation (KEC) International Ltd in December 2018; and package 4 comprising the rural electrification project to be undertaken by NEA itself³⁷⁸. Progress was shown to be satisfactory, with 18.18 percent works completed in package 1, 36.87 percent in package 2, and 48.87 percent in package 3 until June 2022³⁷⁹.

However, the package 1 portion component of the project ran into trouble after the Italian company CMC, which had originally won the contract in February 2019, failed to commence any work, leading to delays in other parts of the project. CMC asked Tanahun hydropower to release its advance payment without commencing any work, and didn't submit the full bank guarantee as was required for the advance payment³⁸⁰. Eventually, CMC's contract was cancelled and handed over to Song Da-Kalika JV.

CMC's refusal to initiate work on the contract matches its performance with the Melanchi drinking water project, which was also funded by the ADB. As noted by several KIs associated both with the government and multilateral institutions, the performance of several international contractors who bid for projects in Nepal is unsatisfactory. The monitoring and evaluation of contractors in such projects is also weak, both from the multilateral institutions' side and the GoN's side, and most KIs acknowledged the role of local agents in acquiring such contracts. As a KI said, 'Commission agents are not just outside the system but also inside. They are the real market makers in Nepal.'

Aviation

Gautam Buddha International Airport, Bhairahawa

GBIA is in the plains of Rupandehi, near Lumbini, the birthplace of Gautam Buddha, an international pilgrimage destination. The proposed international airport was perceived to serve migrant Nepali workers abroad, most of whom come from the Terai region. The expansion and improvement project of the earlier domestic airport was meant to allow the airport to handle international traffic.

The total cost of the expansion project is USD 76.1 million, with ADB investing around USD 37 million in loans and grants, the OPEC Fund for International Development USD 11 million in loans, and the remaining sum funded by GoN. The airport is expected to serve 760,000 passengers by 2030, and was also expected to serve as an alternative international airport in case of shutdowns at TIA, the only international airport in Nepal then. The new runway is 3,000 m long, qualifying it for long-haul aircraft, and the old 1,500 m long runway serves as a parallel taxiway³⁸¹. A new terminal building has been built, but phase II of the project involves the construction of another international terminal building, funded by a part of a USD 150 million ADB loan to upgrade both Tribhuvan International Airport in Kathmandu and GBIA, of which USD 60 million is expected to be spent on GBIA³⁸².

CAAN awarded the NPR 6.22 billion contract in November 2014 to China's Northwest Civil Aviation Airport Construction Group³⁸³. The Chinese contractor had emerged as the lowest bidder among seven other bidders. Other bidders included China Harbour

Engineering's (the same company that built Hambantota port) bid of NPR 6.4 billion, a Spanish-Nepali JV called Sanjose-Kalika Construction's bid of NPR 6.68 billion, China Overseas Engineering Group (bid of NPR 6.77 billion), China's Sinohydro Corporation (bid of NPR 7.2 billion) and Spain's Isolux-Corsan (bid of NPR 7.21 billion)³⁸⁴.

Although construction started in January 2015, ADB in August blacklisted Northwest Civil for submitting fake claims to get the GBIA project. An ADB investigation found that the Chinese firm produced fake documents it had reportedly obtained from Sudan to meet the ICB qualifications according to ADB guidelines. Northwest Civil wasn't allowed to bid for fresh ADB contracts, but CAAN decided to retain the same contractor for the project. A newspaper reported that a bureaucrat had been appointed as director of CAAN to lobby for Northwest Civil and had played a key role in awarding the contract to the company³⁸⁵.

The project faced several hiccups during its construction. In 2015, with the long protests in the Terai against the constitution, there were fuel and construction material shortages. The deadline was then revised to June 2018 from 2017-end. In 2016, additional land was acquired to install an advanced radar at the airport³⁸⁶. Construction was slow enough for the NPC vice-chair to give the contractor a warning in December 2016.

The project ran into controversy after it emerged that Northwest Civil had subcontracted the supplies of various construction material to a Nepali firm called Northwest Infra Nepal, which was owned by the son of former Prime Minister and UML leader Jhalanath Khanal, Nirvik Chitrakar (Khanal), and other local UML leaders. This went against the provisions of the contract signed between CAAN and Northwest Civil. ADB had expressed serious concerns over it, with the bank hiring an international consultant to analyse the risk of contract termination with Northwest Civil³⁸⁷.

A dispute over payments between Northwest Civil and the Nepali sub-contractor stalled work at the construction site from March 2017. Northwest Civil received several warnings not just from Nepali officials, but also from the South Korean design and consultant firm Yoossin Engineering, which was hired to supervise the project³⁸⁸. The Nepali subcontractor was hired to provide workers, and construction materials, fuel, and heavy-duty vehicles. Northwest Civil even paid the subcontractors an advance without any paperwork. But the Nepali subcontractor stalled work for six months, and fled midway without paying the workers and other suppliers. After the subcontractor fled, Northwest Civil was forced to foot the bill, and resumed work in October 2017 even though the payment dispute remained unresolved. The subcontractor was removed only after ADB's intervention.

Northwest Infra Nepal was owned by, apart from Nirvik Chitrakar, Raju Gurung, a local goon and UML supporter; Phurba Sherpa, a UML-affiliated contractor; Shakti Dangol, a close relative of UML leader Khanal; and Manjit Rai, a UML cadre from Ilam, Khanal's constituency. Former PM Khanal is also alleged to be close to China, and his Jhala Nath Khanal Foundation showed fraudulent expenses in the name of anti-snake venom production³⁸⁹.

A former GBIA project official, along with several other KIs, said that there were clear linkages between the Chinese contractor and Khanal's son. Project implementation suffered, and although both ADB and GoN officials warned the Chinese contractor several times, no action was taken against them. A retired senior bureaucrat and KI said this was due to the political patronage provided to Northwest Infra by senior UML leaders. Even CAAN tried terminating the contract with Northwest Civil, but it could not. According to one report, then director general of CAAN, favoured the Chinese contractor and its sub-contractors. "CAAN leadership, using his political clout, allowed the Chinese contractor to illegally appoint a subcontractor namely Nirvik Chitrakar Khanal, son of former premier and CPN-UML leader Jhala Nath Khanal," the report added³⁹⁰. Another report added that the PAC of Parliament was pressed to not probe the delays in GBIA implementation because of vested political interests³⁹¹. Northwest Civil was also alleged to be bringing in fake lighting systems and lobbying with the Chinese Embassy to get them installed³⁹².

Construction was slow on the project. In 2019, it was decided that GBIA would become the world's second airport to be fully powered by solar power. In March 2019, CAAN also awarded a USD 4.83 million contract to install communications, surveillance and navigation systems at GBIA to Aeronautical Radio of Thailand³⁹³. The deadline was extended for the fourth time in December 2019. Meanwhile, GoN started discussing with Munich airport about running operations at GBIA, but a committee recommended not working out the deal via a government-to-government mechanism as such deals had invited several controversies in recent years³⁹⁴.

The airport was finally operationalized in April 2022 after several delays. However, the geopolitics around the airport has continued to plague operations, with only one international airline – Jazeera Airways of Kuwait – currently operating out of GBIA. A clear lack of planning towards business operations and viability has been visible, with CAAN forcing the state airline Nepal Airlines to cancel a Kathmandu-Delhi flight as punishment for defying its instructions to move some international services to GBIA³⁹⁵. The lack of planning was also visible in the fact that although the airport targeted migrant workers as a viable business plan, there was no labour desk to issue permits for migrant

workers in Bhairahawa. Thus, migrant workers flying out of GBIA had to first come to Kathmandu to get the permits, and then go to GBIA to fly out³⁹⁶.

At the Bhairahawa FGD, all participants emphasized the lack of any planning in operationalizing GBIA, and said that the private sector had invested at least NPR 10 billion in new hotels and other tourist infrastructure in anticipation of the airport. ‘Without operationalizing GBIA, the investments would sink’, they said. FGD participants also said the private sector had offered all support to GBIA, but locals were not consulted at all. They said the project had displayed the typical symptoms of corruption, with bid riggings with respect to equipment installation, shady contractors, and lack of planning, all visible in the project. Currently, the new terminal is only operationalized for the Jazeera flight, while domestic travellers have to use the old terminal building. Local KIs also said while the cargo terminal has been built, an access road connecting the terminal hasn’t been readied. Worries about business operations had emerged even during construction, with a 2018 report saying GoN had not made any business plans for an airport scheduled to be operationalized in another year at the time³⁹⁷. This points towards both a systemic failure to plan and operationalize infrastructure projects such as airports as well as GoN’s tendency to accept projects driven by foreign assistance without worrying about profitability. Despite Nepal currently possessing three international airports, international flights currently run only from Kathmandu, while GBIA has three weekly flights scheduled by Jazeera. PIA, on the other hand, has no international flights planned in the near future. Further, GoN continues to press for another international airport in Nijgadh, east of GBIA, as an alternative to TIA. If Nijgadh goes ahead, this will mean Nepal will be able to boast of four international airports within a radius of 100 nautical miles – a rare occurrence. As multiple KIs stated, infrastructure via foreign assistance is an easy way to make money in Nepal’s officialdom. Further, GBIA has run into several issues due to its proximity to the India-Nepal border, India’s suspicions about Chinese involvement in the airport, and lack of air routes.

An advanced Instrument Landing System (ILS) has been installed at GBIA to allow it to operate flights even during low visibility, but because of the way the ILS system has been aligned, Nepal is required to take permission from India due to its compulsion to use Indian air space. However, India is yet to give the permission, which is why the ILS is not yet operational³⁹⁸. A Nepali journalist and KI, however, said the alignment of the ILS could have easily been changed in a manner that did not require Nepal to take permissions from India to operate it. Secondly, despite a joint statement between India and Nepal back in 2014 during PM Modi’s Nepal visit, India is yet to provide more air routes for entry into Nepal. Currently, three air entry routes are used, via Biratnagar, Janakpur and Simara.

Flights entering Nepal from the west have to use the Simara air entry route. Nepal has been consistently pressing India to open up the Mahendra Nagar and Nepalgunj air entry routes to ease flying into the country, but India has not authorised so despite Nepal's concerns. Because airlines flying into GBIA have to fly in via the Simara route, this results in extra fuel costs.

The key issue at GBIA is India's mistrust over Chinese involvement close to its borders. India has long been suspicious of Chinese interest in Lumbini, the birthplace of Buddha, starting from a 2011 proposal by a dubious Chinese non-governmental organization (NGO) called Asia Pacific Exchange and Cooperation Foundation (APECF) to invest USD 3 billion to convert Lumbini into a 'Mecca' or 'Vatican'³⁹⁹. The proposal, which was backed by Prachanda in Nepal, was halted after India expressed serious security concerns regarding the organization. Another Chinese organization has proposed building a 100-meter-tall statue of the Buddha in Lumbini at a cost of more than USD 55 million⁴⁰⁰. Furthermore, an Indian air base is located just across the border, thus raising more concerns from their side.

Indian suspicion of GBIA was most noticeable during Prime Minister Narendra Modi's May 2022 visit to Lumbini. Although GBIA had only recently opened, and an Indian Air Force IL-76 became the first international aircraft to land at the airport⁴⁰¹, three separate helipads were built in Lumbini for Modi's helicopter to land there, bypassing GBIA. A senior government official and KI said India has been unwilling to extend cooperation on GBIA due to the fact that Nepal built it without prior consultation with India. "If we had taken the Indians into confidence before constructing the project, we would not have to face these issues." This was repeated by several other KIs, both in Kathmandu and in Bhairahawa. Indian tourists continue to make up the largest foreign visitors to Lumbini.

Although the airport was only constructed by a Chinese firm using funds from other agency, Indian suspicions were further aroused when former Chinese ambassador Hou Yanqi termed GBIA as a BRI project. Speaking with journalists on 22 April 2022, ambassador Hou said the BRI consists of both grants and commercial loans and that many of the projects China and/or its companies was building in Nepal come under the BRI framework. "It is based on a cooperative modality that includes grants and commercial cooperation... This [BRI] is a long project. The projects that are being constructed in Nepal under BRI have three modalities. First, it is like Gautam Buddha Airport in Lumbini where ADB has invested and Chinese contractors have worked. Second, the modality of Pokhara Airport where China's commercial loans and grants are there and the construction company is also Chinese. And the third modality is like the Tribhuvan International Airport in Kathmandu. The responsibility of improving this airport has been given to a Chinese company and the cost will be borne by the Nepal government"⁴⁰².

The ambassador may have been suggesting the BRI is a flexible initiative that allows China to claim any participation by Chinese companies in any form as being under the BRI modality, but none of the projects she mentioned have been earmarked under the BRI in Nepal. Whether one should read the ambassador's statements as showcasing bilateral progress under her tenure during her last press conference, or whether her comments should be seen against the background of China laying claim to projects being under the BRI framework when they are not declared so by the host country – such as the Padma River bridge in Bangladesh or PIA in Nepal – is open to interpretation. What is clear is that her statements further fuelled India's suspicions with respect to Chinese intentions from the GBIA.

The GBIA project has shown deep issues within Nepal's procurement system in infrastructure projects – despite being funded by a multilateral institution such as ADB that would have had better monitoring systems. From the appointment of a dubious contractor who submitted false documents, appointing subcontractors with close political links, delays in implementation and lack of action due to political pressure, China's own envoy muddying the waters by terming it a BRI project, and Nepal's lack of operational planning along with a failure to convince India to help it operationalize the airport, GBIA is a story that encapsulates the worst practices in Nepal's infrastructure governance.

Although the airport is currently operational, the story doesn't end here. In February 2022, the Ministry of Tourism recommended to the Ministry of Finance to cancel the USD 150 million ADB loan awarded in November 2020 and instead develop both GBIA and TIA expansion projects using Nepal's own resources. Although the MoF rejected the proposal, the Ministry of Tourism's sudden proposal to cancel the ADB loan allegedly came from the then Tourism Minister Prem Kumar Ale himself. The reason was that Ale allegedly wanted the contract to be awarded to China Harbour Engineering Company – the ones who built Hambantota port, and was blacklisted by the ADB in 2018 for corruption in Bangladesh – which could not participate in the new contract⁴⁰³. By cancelling the ADB loan and mobilizing domestic resources, Ale intended the contract to be awarded to China Harbour.

Gautam Buddha International Airport Timeline

Date	Event
1958 July 8	Bhairahawa Airport was built to serve as a domestic airport ^{404 405} .
1977	Bhairahawa Airport was renamed as Gautam Buddha Airport ⁴⁰⁶ .
2006	The Government of Nepal prepared a Master Plan to improve its aviation services and facilities in accordance with the standards of the International Civil Aviation Organization (ICAO) member countries ⁴⁰⁷ .
16 November 2009	The ADB approved a project to support tourism development in the subregion, including separate portions for Bangladesh, India, and Nepal, with the Nepal portion focusing on developing the high-priority tourism circuit in the Lumbini area, at a cost of USD 46.5 million, and with the project expected to close on March 15, 2015 ⁴⁰⁸ .
2010	The Master Plan prepared by the Government of Nepal in 2006 to improve aviation services and facilities was modified by ADB TA 6504 in FY 2009-2010 to accommodate landings of ICAO 4D standard aircrafts, resulting in a revised Master Plan that called for the construction of a new 2,600x45m runway with a 3,000x300m runway stripe at GBA, as well as upgrades to service buildings and terminals for both domestic and foreign use ⁴⁰⁹ .
2010 May 25	The GoN and ADB signed the Loan Agreement to build the Gautam Buddha Airport ⁴¹⁰ . For the construction of the airport in Nepal, the Asian Development Bank (ADB) provided \$58.50 million (consisting of \$42.75 million in loans and \$15.75 million in grants) through its South Asia Tourism Infrastructure Development Project (SATIDP), while the OPEC Fund for International Development (OFID) will provide a loan of \$15 million, and the Civil Aviation Authority of Nepal (CAAN), which is responsible for executing the project, will contribute the remaining amount ⁴¹¹ .
2012	The Master Plan for the airport was updated again under the ADB Loan 2579/Grant 0179 project, which included a concept paper for additional financing to increase the runway, construct a new international terminal, develop an international aircraft apron, and add an instrument landing system, at a total cost of USD 85.6 million ⁴¹² .

2013 December	CAAN opened tender for GBA upgradation as the regional international airport ⁴¹³ .
2014 March 28	ADB grants Nepal an extra USD 30 million loan to upgrade Gautam Buddha Airport in Bhairahawa to an international airport with improved air safety standards ⁴¹⁴ .
2014 October	The Chinese company Northwest Civil Aviation Airport Construction Group obtained the contract for the airport's upgrading ^{415 416} .
2015 January 15	Prime minister Sushil Koirala inaugurated the upgradation of the project and laid the foundation stone for the project construction work ⁴¹⁷ .
2015	The Chinese company illegally hired a subcontractor (Northwest Infra Nepal) without informing the project execution agency ⁴¹⁸ .
2015 August	China's Northwest Civil Aviation Airport Construction Group was blacklisted by ADB for submitting false claims to bag the prestigious GBIA project ⁴¹⁹ .
2016 February 26	Gautam Buddha International Airport construction was inspected by the prime minister, KP Oli ⁴²⁰ .
2016 May 28	Rs. 7.22 billion allocated for GBIA in Nepalese budget 2016/17 ⁴²¹ .
2016 June	The construction of GBIA in Bhairahawa has been hindered by a shortage of gravel and sand, as well as a ban on extracting materials from nearby rivers, due to disagreements over development and environmental priorities ⁴²² .
2016 October	A 3000-meter runway that can accommodate emergency landings is completed at Gautam Buddha International Airport ⁴²³ .
2017 April 7	South Korean consultant Yoossin Engineering Corporation issued a warning letter to the Chinese contractor of GBIA, demanding they resolve the issue with the subcontractor to expedite construction progress on the site ⁴²⁴ .
2017 August	The management team of GBIA in Bhairahawa gave a two-month ultimatum to the Chinese construction company, Northwest Civil Aviation Company, to enhance their performance on the under-construction airport project ⁴²⁵ .

2017 August	The government threatened to revoke Northwest Civil Aviation Airport Company's license if it doesn't expedite development of GBIA by the end of October ⁴²⁶ .
2017 October 9	The Parliament's International Relations and Labour Committee instructed the government to maintain the present contractor for the ongoing construction of GBIA in Bhairahawa, Rupandehi ^{427,428} .
2018 February 27	Due to unsatisfactory progress on the GBIA project, ADB was ready to withdraw its investment in the project ⁴²⁹ .
2018 March 25	ADB representatives urged the contractor to accelerate construction progress ⁴³⁰ .
2018 May 23	Minister for Culture, Tourism, and Civil Aviation, Rabindra Adhikari, stated that the government is considering the possibility of transferring the management and operation of the airport to the private sector ⁴³¹ .
2018 August 20	The government planned to designate the International Finance Corporation (IFC) as the transaction advisory service provider ⁴³² .
2018 October 30	Blacktopping of the runway of the airport started ⁴³³ .
2019 March 7	Aeronautical Radio of Thailand was awarded a contract worth USD 4.83 million to install air traffic management systems, communication, navigation, and surveillance at GBIA ⁴³⁴ .
2019 May 29	Government allocated 3.3 billion for GBIA for the fiscal year 2019/20 ⁴³⁵ .
2019 July	The GoN extended the project's deadline for the third time and expects it to be completed by December 2019 ⁴³⁶ .
2019 December	GBIA plans to conduct test flights for large aircraft ⁴³⁷ .
2020 July	The opening and operation of flights to be started from March 2021 after another delay ⁴³⁸ .
2020 July 15	The attempt to appoint Munich Airport of Germany as the operator officially terminated ⁴³⁹ .
2020 September	92 percent construction work completed ⁴⁴⁰ .

2020 November 20	ADB approves USD 150 million concessional loan to improve TIA and GBIA ⁴⁴¹ .
2020 November	The second package of the project, which involves the installation of communication, navigation, and surveillance, air traffic management, and meteorological equipment becomes uncertain because of AEROTHAI's hesitant to commence work due to concerns about the safety of their workers in light of the rise in Covid-19 cases in Nepal ⁴⁴² .
2021 June	The opening date for GBIA further postponed until early 2022 due to the monsoon ⁴⁴³ .
2021 August 5	To undertake a flying inspection of the newly installed navigation and communication infrastructure at the airport, Nepal approached India for assistance since the original contractor had been staying away because of the Covid-19 outbreak ⁴⁴⁴ .
2021 July 24	GBIA prepared its test operation ⁴⁴⁵ .
2021 December 20	Northwest Civil Aviation Airport Construction Group was placed on the ADB's blacklist for breaking integrity standards and are no longer permitted to work on Nepal's important airport infrastructure development project ⁴⁴⁶ .
2022 January 30	The official opening date set to Buddha Jayanti on 26 May, 2022 ^{447,448} .
2022 February 18	Calibration flights started with the Aero Thai flight from Thailand ⁴⁴⁹ .
2022 March	It was announced that Jazeera Airways would be the first international airline to serve the airport ⁴⁵⁰ .
2022 April 21	The newly built 3,000 m runway was opened while the old one was put into use as a taxiway ⁴⁵¹ .
2022 May 16	The GBIA was inaugurated by Prime Minister Sher Bahadur Deuba. The airport was officially opened with the arrival of the first international flight by Jazeera Airways ^{452,453} .
2022 December 7	CAAN has decided to postpone the compulsory rule for international airlines to shift some of their operations to GBIA ⁴⁵⁴ .

Chinese contractors awarded contracts by GON and/or its institutions

Kathmandu-Nijgadh Terai Fast Track Road Project

An expressway connecting Kathmandu to the Terai plains in the south was conceived of during the Panchayat era, but went nowhere until 1992, when the National Planning Commission and the Danish Development Cooperation conducted a feasibility study. With the civil war and the subsequent political transition, the project continued to remain on the backburner until 2008, when ADB prepared a feasibility report and the GoN proposed Nijgadh in Bara district as the site for an alternative international airport. The Nepal Army opened up a track by 2011, but no international investors were keen on the project⁴⁵⁵.

In 2014, three Indian companies – Infrastructure Leasing and Financial Services Ltd (IL&FS), Larsen & Toubro, and Reliance Infrastructure – expressed interest, but the latter two pulled out citing viability issues. IL&FS then set up a consortium with two of its companies and Suryavir Infrastructure. The government led by NC leader Sushil Koirala awarded it the contract in 2015 on the Built, Own, Operate and Transfer (BOOT) model, assuring it a minimum revenue guarantee of NPR 15 billion annually if traffic was inadequate to generate profits. GoN had also offered a loan to the consortium at subsidized rates for the expressway⁴⁵⁶.

The controversial decision was challenged in the Supreme Court, which issued an interim order to halt the contract. In November 2016, facing criticism from all sides and also a change in government, GoN decided to annul the contract with IL&FS. IL&FS had prepared a DPR estimating costs to be NPR 112 billion; the project costs had consistently increased from ADB's NPR 56 billion estimates in 2008 to NPR 94 billion in 2014⁴⁵⁷.

In May 2017, GoN decided to hand over the project to the Nepal Army despite reservations from the National Planning Commission on grounds that the Army had no technical expertise or experience in building such expressways⁴⁵⁸. The NPC had suggested roping in international and national contractors on the project, but the recommendation was shot down by then Minister for Physical Infrastructure Ramesh Lekhak.

Because IL&FS had already prepared a DPR, the Army sought to buy the DPR from the consortium. However, the Army offered less than a third of IL&FS's asking price of NPR 608 million (USD 5.8 million), saying the DPR costs were far too high for a report prepared within three months' time. There were counter-allegations that the consortium was in league with GoN and Army officials to inflate the DPR costs, with the Army at one point allegedly ready to pay NPR 1 billion for the DPR⁴⁵⁹. In January 2018, the Army decided to reject the DPR and prepare a fresh one based on the ADB feasibility study⁴⁶⁰. As a result, IL&FS claimed NPR 2.37 billion as compensation for preparation of the DPR since the original agreement stipulated the company would not charge for the DPR if it was awarded the contract to build

the project⁴⁶¹. GoN had also decided to build the project under an EPC model than a BOOT model as it was originally envisaged.

Land acquisition for the project ran into opposition as early as March 2018, when locals of Khokana, on the outskirts of the Valley, began to protest on grounds of the project overrunning their traditional cultural spaces as well as insufficient compensation. Nonetheless, the Army commissioned a South Korean company Soosung Engineering & Consulting Company to prepare a new DPR at the cost of NPR 101.5 million, which was submitted in 2019⁴⁶².

However, the Army had begun work on the Fast Track even before the DPR was prepared. The Army proposed two new tunnels to avoid overlap with the Kanti Rajpath, a highway project the Army had undertaken in the 1960s, that would add NPR 5 billion to the overall costs⁴⁶³. Army officials had allegedly been pressuring the GoN to accept the proposal, which was not recommended by other engineers. An editorial at the time wrote, “There still is the impression that Army can do no wrong and that this apolitical institution thinks of Nepal’s good and nothing less. However, recent trends show otherwise”⁴⁶⁴. The Army said independent Nepali consultants advised the addition of new tunnels.

The DPR prepared by Soosung reduced the total length of the highway to 72.5 km from the earlier 76.2 km⁴⁶⁵. The four-lane highway with 50 meters right of way would have 87 bridges. Similarly, three tunnels will be constructed at Mahadev Danda (3.35 km), Dhedre (1.63 km) and Lendanda (1.43 km), for which international bidding is yet to begin. The project costs had risen to NPR 175 billion, with an additional NPR 63.19 billion more than the earlier estimate. The Army said it would construct 17 km of the project on its own, hire ‘dependable’ Nepali contractors for 37 kms, and assign foreign contractors to build the remaining 22.2 km that included tunnels and bridges. The Army also asked for an additional NPR 680 million as incentive to its staff working on the project⁴⁶⁶. For 16 of the bridges, the Army called in international bids and shortlisted six international companies – five from China and one from Turkey⁴⁶⁷. However, in December 2019, the Army had to scrap its decision to shortlist the companies because the evaluation criteria were leaked to the shortlisted bidders even before the bid was called⁴⁶⁸. No action was taken either against Army officials or the shortlisted companies.

The Fast Track project has seen some intriguing developments in the way its contracts have been awarded. Our team spoke to several KIs, some of whom were from firms bidding for the contracts, others from the GoN deeply involved with the project, and also obtained documents that support our arguments. Several of the contracts – including the most recent one – have been controversial, with litigation also reaching the Supreme Court with respect to the contract awarding process. Companies that have already received contracts to undertake various works under different packages are China First Highway Engineering Co.Ltd., Xingrun-Ashishtundi JV, Kumar-RoshanSichuan JV, Mahendranagar and CAMCE-SDLQ China JV, and Poly Changda Engineering Co. Ltd, China.

Table 2. Details of Goods and Spare parts Bought in FY 2079/80 and 2078/79 (KTFT Road Project)

S. N.	Items	Qty	Company Name	Contract Date	Completion Date
1.	Contract for Construction of Double Lane Dual Carriageway Standard Expressway Road, Bridges and Allied Works from Ch. 49+800 to Ch. 57+400; Contract ID: (KFT/ICB/WORKS/R&B/078/079/3)	Various	Kumar-Roshan-Sichuan JV, Mahendrapur	17 Jan. 2022	27 Oct. 2024 1000 Days
2.	Construction of Double Lane Dual Carriageway Standard Expressway Road, Bridge, Toll Plaza, Interchange and Allied Works from Ch. 65+160 to Ch. 72+529; Contract ID; (KTFT/ICB/WORKS/R&B/078/079/5)	Various	CAMCE-SQLQ JV, China	21 Feb. 2022	3 Nov. 2024 970 Days
3.	Contract for Construction of Double Lane Dual Carriageway Standard Expressway Road, Bridge and Allied Works from Ch. 57+400 to Ch. 65+160; Contract ID: (KTFT/ICB/WORKS/R&B/078/079/4)	Various	Poly Changda Engineering Co. Ltd., China	21 Feb. 2022	3 Nov. 2024 970 Days
4.	Construction of Various Prefab Buildings at Mahadevtar Base Camp, Makwanpur (KTFT/NCB/WORKS/079/080/02)	Various	To be opened on 5 Feb. 2023		
5.	Construction of Various Prefab Buildings at Lanedada Base Camp, Makwanpur (KTFT/NCB/WORKS/079/080/03)	Various	To be opened on 5 Feb. 2023		

6.	Contract for Construction of Double Lane Dual Carriageway Standard Expressway Road, Bridges and Allied Works from Ch. 49+800 to Ch. 57+400; Contract ID: (KFT/ICB/WORKS/R&B/078/079/3)	Various	Kumar-Roshan-Sichuan JV, Mahendrapur	17 Jan. 2022	27 Oct. 2024 1000 Days
7.	Construction of Double Lane Dual Carriageway Standard Expressway Road, Bridge, Toll Plaza, Interchange and Allied Works from Ch. 65+160 to Ch. 72+529; Contract ID; (KTFT/ICB/WORKS/R&B/078/079/5)	Various	CAMCE-SQLQ JV, China	21 Feb. 2022	3 Nov. 2024 970 Days
8.	Contract for Construction of Double Lane Dual Carriageway Standard Expressway Road, Bridge and Allied Works from Ch. 57+400 to Ch. 65+160; Contract ID: (KTFT/ICB/WORKS/R&B/078/079/4)	Various	Poly Changda Engineering Co. Ltd., China	21 Feb. 2022	3 Nov. 2024 970 Days

Source : Nepal Army website

The contracts for the various packages of the project began to be awarded from 2018 when UML leader KP Oli was the Prime Minister, his close affiliate Ishwor Pokhrel was the Defence Minister, and Purna Chandra Thapa was the Chief of Army Staff of the Nepal Army. In May 2020, Nepal Army chose the financial proposal submitted by Yooshin Engineering Corporation of South Korea and appointed it the international consultant for the proposed tunnel and sky-bridges⁴⁶⁹. However, in July 2020, the World Bank blacklisted Yooshin Engineering after being involved in fraudulent practices in an aviation project in Vanuatu⁴⁷⁰. Other companies shortlisted in the consulting bid filed a complaint with the Public Procurement Monitoring Office (PPMO) stating the Army had favoured the Korean company unduly. Meinhardt (Singapore) Pvt Ltd and others lodged a complaint to the project office as well as the PPMO stating that they learnt through media reports about the decision to award the contract to Yooshin Engineering Corporation. The April 2020 letter stated, “We, the Joint Venture of Meinhardt (Singapore) Pte. Ltd, Kyong Dong Engineering Co. Ltd., Korea and Korea Consultants International Co., Ltd. Korea, have

not been formally notified by the client (Nepal Army, Kathmandu Terai Madhesh Fast Track Road Project), either through hard copy or via electronic means, about its intention to award the Letter of Intent to Yooshin Engineering Corporation, Korea.” The letter by other bidders provides insight into how the international consulting contract was awarded. The letter went on to state:

“We believe the consulting services for design and construction supervision deserves an objective transparent scrutiny in the evaluation process for selection of the best proposal to select an appropriate consultant to carry forward Government of Nepal’s vision of this expressway project which carries the expectation and the hopes of people of Nepal... [We] want to bring to your notice fundamental procedure lapses in awarding the letter of Intent to Yooshin Engineering Corporation. Such procedure lapses undermine the efficacy of the process to objectively evaluate the best proposal from the bidders. We have two fundamental objections of the procedure lapses of the client (Nepal Army, Kathmandu Terai Madhesh Fast Track Road Project). The whole world and the entire country of Nepal currently is in a state of lockdown due to COVID-19... In this precarious situation, it is unimaginable to even think that negotiations were held between the first-ranked bidder (Yooshin JV) and the Client within such a short notice; provided that the Yooshin’s authorized person has to receive consent and authorization letter from the JV to participate in the contract negotiation meeting within hours of knowing that they are ranked first.”

Further, according to two senior bureaucrats and KIs, the Nepal Army inserted provisions that seemed to favour Chinese contractors, such as the provision that only contractors who had no pending litigation or fewer litigation charges against them could bid for the contracts. Almost every contractor across the world is said to have litigation charges against them, but Chinese firms can easily get litigation-free certificates, so this provision hugely favours them, the bureaucrats said. According to them, inserting such a provision was a deviation from policy, but was insisted upon by the Army’s leadership.

All KIs we spoke to regarding the Fast Track project said there were further irregularities while awarding the contract to the Chinese contractors. The KIs said that because the different packages were contracted under the EPC model which Chinese contractors are better versed and more experienced in, it was easier for them to win the bids. The KIs also alleged that the local Nepali agents representing the Chinese firms are quite influential and are close to the top leadership of the Nepal Army.

Further, China State Construction Engineering Corp. and Poly Changda Engineering Co. Ltd were selected in the first phase to build the Mahadevtar tunnel under Package I, and the Dhedre and Lanedanda Tunnels under Package II respectively⁴⁷¹. The combined costs of the two contracts were estimated to be NPR 44 billion. However, the PAC of Parliament

found serious procedural flaws in the pre-qualification process and directed the Army to scrap the contract process and initiate a new one. China State Construction Engineering had been awarded the Mahadevtar tunnel contract in the first phase, but failed to qualify for the second phase. Only Poly Changda was selected in the second phase, with the Army selecting only one company out of the 22 bidders in the global bidding process, which is against the PPA⁴⁷².

Under Nepali procurement laws, there are three phases for the selection of international companies. In the first phase, global bids are called. The second is the pre-qualification phase, in which bidders' technical documents are evaluated and shortlisted. In the third phase, the project asks for financial proposals from bidders that have passed the technical evaluation, and the contract is awarded to the bidder who quotes the lowest price for the project. Then PM KP Sharma Oli publicly expressed his dissatisfaction over the PAC's suspension of the contract process following the committee's directive⁴⁷³. He said it was wrong to stop development work even if corruption or irregularities were found. The Nepal Army continued with the process, however, not heeding the PAC's recommendations.

A member of the PAC and a KI said that local agents of the Chinese firms had lobbied hard with the military leadership to retain the contracts. The KI also said the former army chief had favoured Poly Changda due to personal connections. Multiple Members of Parliament (MP)s and KIs said Rajan Rayamajhi, brother-in-law of the then Chief of Army Staff Thapa, and the contractor Lokendra Karki, brother of former minister and Nepali Congress leader Gyanendra Bahadur Karki, were active in lobbying for the Chinese firms. Ang Tshering Sherpa, the owner of Yeti and Himalaya Airlines who died in a 2019 helicopter crash and was reputed to be close to PM Oli, was the local representative for Poly Changda. Subsequent to his death, Lokendra Karki was appointed the local representative for Poly Changda.

Two MPs who were members of the PAC told us they were aware that their instructions to halt the contract process would not be followed by the Army because the institution did not abide by civilian instructions. They alleged a strong nexus between the involved politicians, the Army leadership, and the contractors. The PPMO was instructed by the PAC to smoothen the process and prepare the necessary documents and guidelines essential for a new tender process. "But the PPMO never came up with the documents because we knew that is not possible," one member of the PAC said. The Nepal Army then opened the financial proposals of the two packages the next day and started evaluating their proposals.

The PAC had said in its April 2021 decision that the bidding was “not competitive”. “[As] only two companies entered the pre-qualification process in the first package and only one competed in the second package, we directed to cancel the second package and go for pre-qualification bidding once again. The committee deems it essential to ensure competitiveness, transparency and economy in the procurement process as per the preamble of the Public Procurement Act, 2007 and Public Procurement Rules, 2007, regarding the second of the two packages in the EPC Contract Pre-Qualification (PQ) case of tunnel and bridge of Kathmandu-Terai Fast Track. For this, the committee decided to cancel the procurement process of Package 2 (KTFT/ICB/PQ/076/077-2) for pre-qualification as it is found that competition in the bidding was found to be prohibitive... The Committee has decided to direct the GoN to proceed with the procurement process as per the rules”⁴⁷⁴. PAC member Meena Subba told the press, “There is ground to be skeptic why NA selected only two for the second phase when it had received 21-22 bidders”⁴⁷⁵.

The Nepal Army and Ministry of Defence separately urged the PAC to reconsider its decision. But the PAC did not do so. Nonetheless, the Army went ahead with the two contractors and did not initiate a new contract process. In September 2022, the Parliamentary Development and Technology Committee instructed the government to take action against those involved in illegally awarding the contract for the project⁴⁷⁶. The parliamentary panel found that there had been irregularities while awarding the contracts of package number 4 and 5. A joint venture between Nepal and China, Kumar/Roshan/Sichuan JV had received the contract under package 3. Poly Changda Engineering Company was awarded package four and CMEC/SDLQ JV was awarded package 5.

While details for the other packages are not available in the public domain, another controversy erupted over the awarding of Package 6. The package constituted the construction of a double lane dual carriageway standard expressway road, bridge, slope stabilisation, interchange, toll plaza, and allied works. A total of 12 bids were received by the Nepal Army from two Indian Parties – namely Afcons Infrastructure and Gayatri Projects – and 10 Chinese companies. One of the Chinese bidders, China First Highway Engineering Co. Ltd., was declared to be technically unfit to participate in the financial bid due to a conflict of interest. The Army had found that the Chinese CCB Financial Asset Investment Company Limited had a stake in two of the bidders – China First Highway Engineering Co and Zhongding International Construction Group Company Limited⁴⁷⁷. In an email dated 1 September 2022, the Nepal Army said five companies out of the 12 bidders had qualified for the financial evaluation, which included four companies from China and one from India – Afcons.

China First Highway then registered a complaint with the Public Procurement Review Committee (PPRC) stating that CCB Financial Asset had no stake in Zhongding International. The Nepal Army had given bidders 15 days to make arrangements to attend the financial bid opening, which was to be held on 16 September 2022. But in an email dated 15 September 2022, the financial bid opening was postponed until further notice. The PPRC then ordered the Nepal Army to include China First Highway's bid for financial evaluation. In an email dated 6 November 2022, the Nepal Army said it had opened the revised financial bid where they qualified and included China First Highway, and in a hasty short notice the next day announced China First Highway to be the lowest bidder. Afcons then filed a writ petition in the Supreme Court on 24 November against the Nepal Army's decision to award the LoI to the Chinese company, alleging foul play and that the PPRC did not have the authority to include China First Highway into the bid.

The revised financial bids of the six companies were as follows:

- 1) China First Highway Engineering Co. Ltd: NPR 1,807.86 crore [inclusive of 2.7 percent discount]
- 2) Afcons Infrastructure Ltd, India: NPR 1,999.49 crore
- 3) China Overseas Engineering Group Company Limited, China Railway No.2 Engineering Group Co., Ltd: NPR 2,046.86 crore.
- 4) Sinohydro Corporation Limited and Powerchina Chengdu Engineering Corporation Ltd, China: NPR 2,216.84 crores.
- 5) China State Construction Engineering Co., Ltd., China: NPR 2,758.01 crores
- 6) Poly Changda Engineering Co., Ltd., China: NPR 4,208.14 crores.

Because the Supreme Court hadn't issued a stay order on the contract awarding process, on 23 February 2023, Nepal Army wrote to Afcons' legal representative informing them that they had signed a contract with China First Highway on 10 January 2023.

KIs we spoke to for this project said the re-inclusion of China First Highway in the tender process was a ploy for Afcons India to lose the project. They emphasized that since the very beginning, the Fast Track project had been awarding its tenders to Chinese firms conspicuously, and alleged that this was also because some influential people within the institution wanted to ensure Indian companies did not get the tenders. While India has not been too pleased with the way the Fast Track Project has kept out both IL&FS and now Afcons, it was also suggested that the awarding of contracts to Chinese companies in this project meant ties between the Indian Army and the Nepal Army may not be as close as they once were. The Army has faced a constant barrage of criticism for its inability to finish the project, as well as the shady procurement issues that have emerged at every step. The fracas in the project also shows its lack of technical and other expertise in overseeing a project of this magnitude.

The Fast Track Project has also seen land acquisition issues at various places, along with criticism that its contractors have haphazardly cut down trees in the name of the project. Although the project remains key for Nepali policymakers, its progress and the Nepal Army's lack of oversight has been sore point, revealing all the weaknesses within the existing procurement systems. In May 2023, the Nepali Army proposed a further NPR 45 billion cost increase for the project⁴⁷⁸. In the fiscal year 2023/24 budget, the government has allotted a total budget of 22.5 billion for the construction of the Terai-Madhes Fast Track. However, this allocation falls short of the amount requested by the Nepali Army⁴⁷⁹.

Chinese contractors in Nepal Telecom's 4G and 5G expansion

The telecommunications sector in Nepal is overseen by the Nepal Telecom Authority (NTA), while telephone services – including mobile telephony – is provided by various service providers such as Nepal Telecom and Ncell (a private sector company owned by Axiata Group Berhad, a Malaysian conglomerate). The two companies hold almost 97 percent share in the Nepali market. Other companies in the market are Smart Telecom and United Telecom. The following case study reports on Nepal Telecom – a state-owned enterprise – and its contracts with Chinese contractors in the sector. Public data for other private operators is not available.

In April 2016, Nepal Telecom decided to launch the 4G programme⁴⁸⁰. By then, the number of mobile subscriptions in Nepal had exceeded the total population of the country (27.85 million versus a population of 26.49 million)⁴⁸¹. Internet penetration had also increased to 44.89 percent of the total population in 2015. However, despite applications for 4G rollout, NTA had been refusing to go-ahead until the Ministry of Information and Communications decided to adopt the 'technology neutrality' policy and allow telecom operators to introduce 4G services using the same 1800-Megahertz (Mhz) band that was being used for 3G services⁴⁸². In July 2016, NTA amended its radio frequency policy, with 'the annual frequency fee for 1 Mhz bandwidth of the 900 Mhz band...increased to Rs 24 million from existing Rs 12 million. "The annual frequency fee for 1Mhz bandwidth has been increased to Rs 19 million from existing Rs 8 million."⁴⁸³ By October, NTA had decided to approve 4G licenses for NT⁴⁸⁴. In December 2016, NT signed a deal with China Telecom Global for a terrestrial cable route to deliver internet protocol (IP) service via Rasuwa via optical fibre⁴⁸⁵. This would allow Nepal to connect to the internet via Hong Kong; until then, NT was linked to other countries using Indian telecom providers⁴⁸⁶. The optical fibre was initially to be laid via the Arniko Highway, but after the 2015 earthquake, it was decided to shift the location to Rasuwagadhi.

NT launched its 4G services in January 2017. Reports indicated NT would start purchasing internet bandwidth from China Telecom by May 2017, ending Indian monopoly over Nepal's

internet services. The agreement was signed in the aftermath of the 2015 blockade, and was motivated by Nepal's desire to reduce its economic dependence on India. NT officials emphasized that internet services would not be disrupted due to China's firewall systems that blocked several popular global websites like Google because NT would be tapping into China Telecom's Hong Kong-based servers⁴⁸⁷. NT's 4G expansion plans also hit a roadblock with the service only being launched in Kathmandu and Pokhara by July 2018, as the Commission for the Investigation of Abuse of Authority (CIAA) was investigating the global tender called by NT for the 4G expansion⁴⁸⁸.

The CIAA investigation was launched in February 2018 after it was alleged that the bids offered by suppliers were much higher than expected⁴⁸⁹. The tender was divided into three packages and was called for in November 2017. The first two packages called for the installation of 4G towers and infrastructure, and the third to install the core network for 4G transmission. Chinese companies led the bid in all packages, with Huawei and Zhong Xing Telecommunication (ZTE) competing for 4G towers and infrastructures; and Huawei, ZTE and Singapore company Mavenir competing for the core network package. Huawei had bid NPR. 1 billion, ZTE NPR 1.5 billion, and Mavenir had quoted a price of NPR 2 billion for the core network. Similarly, only Chinese companies had bid for the first two packages which had been divided by regions (one for the central and mid-western regions and the other for eastern, western and far-western regions). China Communications Services International (CCSI) had bid NPR 8.47 billion for the first package while ZTE had bid NPR 9.98 billion. CCSI bid NRs. 8.22 billion for the second package, while ZTE bid NPR 8.89 billion⁴⁹⁰.

Reports alleged that the tender process and requirements had been designed to meet Huawei's specifications⁴⁹¹. Another news report alleged NT's contract for 4G expansion had been overestimated⁴⁹². A KI involved with NTA said while Huawei had bid a lower price, ZTE officials had also attempted to persuade NTA officials to investigate whether Huawei's tender bid was in order. The minister of communications at the time, UML leader Gokul Baskota, was also accused of unjust preference towards certain companies⁴⁹³. Baskota was said to be on unfavourable terms with NT director-general Kamini Rajbhandari, who was fired from her post in August 2018⁴⁹⁴. Baskota was also caught on audio tape in 2020 demanding NPR 700 million as commission from a Nepali agent for KBA-NotaSys, a Swiss company vying for the contract to print passports and other sensitive material⁴⁹⁵. Baskota resigned as minister subsequently.

In February 2019, NT awarded the NPR 19 billion 4G expansion contract to CCSI and ZTE after the CIAA directed the government to move ahead with the expansion. CCSI

received the contract to build the radio access network infrastructure and 4G towers, while ZTE got the contract for the core network⁴⁹⁶. It is not clear how ZTE got the contract despite its bid of NPR 1.5 billion being higher than Huawei's original bid of NPR 1 billion. CCSI would supply Huawei's radio equipment for the contract⁴⁹⁷. As part of the agreement, both ZTE and CCSI would also provide equipment for a test run of 5G networks.

However, 5G tests were delayed because NT had not paid CCSI, with the latter writing a letter to NT in June 2022 saying, "We have been reminding Nepal Telecom and reiterated in writing on different dates and verbally in almost all meetings about the critical financial situations that we are facing due to the development of fund deficit after the expenditure exceeded the budget allocated for those contracts... We have also intimated Nepal Telecom in our previous letters that CCSI will not be liable for all the consequences that may arise due to the suspension of the works due to fund deficit"⁴⁹⁸. CCSI claimed only 2 out of the 20 outstanding payment claims had been fulfilled. NT officials however rejected the claim.

The news report also suggested the American ban on Huawei, ZTE, Hytera Communications, Hangzhou Hikvision Digital Technology, and Dahua Technology in November 2022 had influenced the delay in payments to CCSI, which was supplying Huawei equipment. But NT officials rejected the idea, stating 5G trials were delayed because there weren't adequate devices on the market to support 5G. Another possible reason for the delay was the unwillingness of the GoN to allow private telecom operators like Ncell to test 5G before the SOE NT. As of February 2023, NT had 18.95 million mobile broadband users, while Ncell had 8.88 million users⁴⁹⁹. A KI said even during the 4G rollout, NT officials asked for a 3-month headstart over Ncell as the former would have to issue tenders unlike the private company.

In 2018, the PMO had awarded a NPR 54 million contract for a video-conferencing system to CCSI through direct negotiations bypassing public procurement laws. A news report stated, "The decision to award the contract to Huawei, cancelling open competition, comes just one and half months after [PMO IT consultant and president of fintech company Esewa Asgar Ali] paid a visit to China at the invitation of Huawei Technologies. Republica has obtained evidence that computer engineer at PMO [Hari Prasad] Pokhrel and Kshitiz Rimal, son of [then Prime Minister KP Oli's] chief political adviser Bishnu Rimal, accompanied Ali during the Huawei-sponsored visit"⁵⁰⁰. Both Kshitiz Rimal and Ali were accused of conflict of interest, and the latter was also accused of lobbying NT officials to purchase equipment from Huawei for the 4G expansion. Huawei entered the Nepali market in 2014⁵⁰¹. While Republica alleged CCSI was the international agent of Huawei, the latter has denied such charges.

Another media organization reported that NT has also given the contract for its billing system to a Chinese company, AsiaInfo. The agreement, which was renewed in 2023, is reportedly at a cost of NPR 3 billion for four years, with a further year's extension provision⁵⁰². However, the company has been accused of running an outdated billing system that has resulted in several network issues in recent years, leading to NPR 3 billion not reflecting in the payments. The report alleged that such abnormal variation in billing could only be the result of collusion with NT officials. AsiaInfo has reportedly been outsourced for the billing system for a decade now. AKI formerly with NT said the telecom company now regularly outsources as many operational components as it can. Interviews with multiple KIs involved both with NT and NTA suggested most companies – including Chinese ones – were involved in lobbying for telecom contracts inside Nepal. Chinese companies usually bid the lowest, but because there were limited number of suppliers in the industry, lobbying by companies was very common. “The difference between European and Chinese suppliers is that while Europeans maintained quality and quantity, Chinese companies do not have similar quality standards. While they show certifications for their products, sometimes the certifications themselves are faulty,” one KI formerly with NT said.

In March 2020, the NT Director-General Dilliram Adhikari told a news website that in some towers, Chinese antennae had been used instead of the contracted American equipment during the 4G expansion⁵⁰³. The Chinese equipment was cheaper, although the tender costs remained the same, with NT paying the contractor for American equipment. It is not clear who the Chinese contractor was, although CCSI had been given the tender to install 4G towers throughout the country. Adhikari told the site that the company that made the antennae shut down, which is why NT had to switch to Chinese antennae.

In a different context, the KI formerly with NT said, “No European ambassador can match the lobbying the Chinese ambassador can do. The Chinese government actively assists its companies to get contracts at reduced costs.” While emphasizing that price remained the main factor in awarding telecom contracts to Chinese companies, they said that companies from other countries were equally active in lobbying for contracts. The KI formerly with NTA said Huawei and ZTE are the primary equipment suppliers for both NT and Ncell in Nepal.

Bheri Babai Diversion Multipurpose Irrigation Project

The Bheri-Babai Diversion Multipurpose Irrigation Project (BBDMIP) was initially thought of in the 1970s as part of the Babai Irrigation Project study. The Japanese agency JICA carried out a feasibility study in 1998, under which the BBDMIP seeks to create all-year-round irrigation infrastructure through inter-basin water transfer⁵⁰⁴. The project is the first of its kind in Nepal, and when completed, will provide irrigation facilities to

over 51,000 hectares of agricultural land in Banke and Bardiya districts⁵⁰⁵. The project envisages a 12 km long tunnel through which water will be diverted from the Bheri river to the Babai river at 40 cubic metres per second, and also generate 46 MW of electricity.

The project is to be wholly funded by Nepali sources, and is estimated to cost NPR 33.19 billion rupees⁵⁰⁶. Accordingly, 51 percent of the funds will be generated from the three tiers of Nepali government (26 percent federal, 20 percent Karnali province, 5 percent local government sources), and the remaining 49 percent will be funded by raising money from the Nepali public. Twenty-nine percent of funds will be raised by a public offering of shares across Nepal, 10 percent shares will be offered to Karnali province residents, and 10 percent shares will be offered to residents of the local units impacted by the project⁵⁰⁷. Of these funds, 40 percent will be diverted towards civil works, 35 percent towards tunnel construction and 2 percent towards tunnel construction consultancies, and 11 percent will be invested towards hydro-mechanical production and installation⁵⁰⁸.

The contract for the tunnel was jointly awarded to China Overseas Engineering Group Co. Ltd and China Railway No. 2 Engineering Group Co. Ltd in 2015 with a bid of USD 90 million⁵⁰⁹. Both companies are subsidiary units of China Railway Group Ltd⁵¹⁰. Construction on the tunnel began in October 2016, using a tunnel-boring machine (TBM) from American company Robbins⁵¹¹. The tunnel was completed in 2019, a year before its deadline. Both the then Chinese ambassador and the American ambassador were present for its inauguration, which was conducted by then prime minister KP Oli⁵¹². Three months later, in July 2019, the project awarded a Nepali-Chinese joint venture company called Guangdong-Yuantian-Raman JV the NPR 6.16 billion contract for the construction of the headworks, surge shaft, penstock and powerhouse of the hydropower component of the project⁵¹³. Three other Chinese JV companies and an Indian JV had also been shortlisted for the component⁵¹⁴. Guangdong Yuantian Engineering is a subsidiary of Guangdong Construction Engineering Group Corp.

The NPR 2.13 billion contract for the third component – the hydro-mechanical component – was awarded to Chinese company Zhejiang Orient Engineering Company in December 2021. The hydro-mechanical component includes construction of the headworks, the powerhouse and the dam⁵¹⁵. By February 2023, the project had reported a 59.1 percent progress rate despite a project deadline of Fiscal Year (FY) 2022-23, with officials saying the construction of the headworks had been delayed due to the contractor⁵¹⁶. In March 2023, the BBDMIP cancelled its consultancy contract with Iranian company Mahab Ghodss after the latter stopped working on the project for a year. The company had been hit with American sanctions and was put on the blacklist⁵¹⁷.

Sunkoshi Marin Diversion Multipurpose Project

Similar in scope as the BBDMIP, the Sunkoshi Marin Diversion Multipurpose Project (SMDMP) also envisages the diversion of the Sunkoshi river's waters into the Marin river and onwards into the Bagmati river to irrigate 122,000 hectares of agricultural land in the plains, primarily districts of Madhesh Province. The project, estimated to cost NPR 83.5 billion, will also construct a 12-metre-high barrage across the Sunkoshi River and generate 28.6 MW of electricity from the Marin river. While the irrigation scheme is projected to cost NPR 37.3 billion, the hydroelectricity component will cost NPR 46.19 billion⁵¹⁸.

In February 2021, the Chinese construction company China Overseas Engineering Group Co. Ltd. won the contract to construct the 13-km-long tunnel. China Overseas had put in a bid of NPR 10.05 billion, almost NPR 6 billion less than the government-quoted price, pointing towards the mechanisms of lowest bid procurement practices in Nepal⁵¹⁹. The tunnel is being bored using the same TBM as in the BBDMIP by the American Robbins Company⁵²⁰. The deadline for the tunnel construction is three years from the start of construction⁵²¹. However, reports suggested construction had begun only in October 2022, 19 months after the contract was signed⁵²².

The NPR 12.5 billion contract for the construction of the dam and powerhouse has been awarded to a joint venture between Indian company Patel Engineering and Nepali company Raman Construction, although the contract agreement hadn't been signed as of writing⁵²³.

Upper Tamakoshi Hydropower Project

The 456 MW run-of-the-river Upper Tamakoshi project is the largest hydropower project currently operational in Nepal and came into operation in July 2021. It is also the largest hydropower project funded by domestic sources as of yet, with the Upper Tamakoshi Hydropower Limited (UTHL) an autonomous company floated by the NEA whose 51 percent equity is held by four large Nepali state-owned entities: the NEA (41 percent), NT (6 percent), Citizen Investment Trust (2 percent) and Rashtriya Beema Sansthan (2 percent). Public offerings of 15 percent to the Nepali population and 10 percent to residents of Dolakha district, where the project is located, were made. The remaining 24 percent stake is held by contributors to the Employees' Provident Fund, NEA and UTHL staff, and the staff of institutions that have loaned funds to the UTHL⁵²⁴. The project was heralded as a gamechanger when it was operationalized because of its capacity, which allowed Nepal to become fully self-reliant on electricity, and derive Nepal to a power-surplus state during the peak monsoon season.

The project began in 2011, with the contract for the civil works awarded to Sinohydro Corporation Ltd from China; the electro-mechanical contract to Andritz Hydro GmbH of Austria; hydromechanical works to Texmaco Limited of India, and transmission line contracts to KEC International Limited, India⁵²⁵.

However, the project faced several setbacks during its construction, due to which its costs rose from an earlier estimate of NPR 35 billion to NPR 53 billion, along with interests to be paid estimated to be NPR 32 billion⁵²⁶. The project was initially supposed to be completed by 2016. However, the 2015 earthquake hit the project area hard, when 79 percent of the works had been completed. Several hundreds of foreign workers from India and China were also stranded in the project area due to the access road being totally destroyed in the quake⁵²⁷.

The project also saw disruptions due to local protests on the distribution of shares⁵²⁸. But the primary cause of delay subsequent to the earthquake and the 2015 Indian blockade was the slow pace of progress shown by Indian contractor Texmaco Limited⁵²⁹. Construction work stalled for months in 2018 when Texmaco said it lacked the expertise to install penstock pipes⁵³⁰. Officials also said Texmaco had given a slew of different reasons for its slow progress such as difficulty in transportation^{531 532}. Subsequently, NEA officials put pressure on Texmaco to sub-contract the installation of penstock pipes to Andritz Hydro of Austria, who had also been given the electro-mechanical contract. An agreement was signed between the three in January 2019, and the Austrian contractor was said to have begun work immediately⁵³³.

In August 2021, SinoHydro filed a complaint at the Ministry of Home Affairs alleging the local administration and district officials had obstructed them from transporting the equipment to another project site⁵³⁴. NEA officials alleged that the obstruction was a result of local authorities and officials trying to bargain for the equipment that the company could auction off.

The first turbines of the project were operationalized in July 2021, and by March 2022, the project was fully operationalized⁵³⁵. However, despite being fully operationalized, it continues to run into various issues – some local, others transnational.

In 2021, India issued a new directive called the Procedure for Approval and Facilitating Import/Export (Cross Border) of Electricity. The procedure included a clause (6.3(i)) that prohibited trade with power plants that had ownership from any country that shares “a land border” with India but doesn’t have a bilateral power treaty with India — indicating China and Pakistan⁵³⁶. The implication of this proposal for the Upper Tamakoshi project was

that India has refused to buy electricity generated by this project due to the involvement of Sinohydro in the construction phase, despite the project being wholly Nepali-owned and also saw the participation of both Chinese and Indian contractors, as well as Austrian and Norwegian companies. Although Indian officials are yet to state it, multiple reports indicate India has asked Nepal not to list the project as an export-oriented one⁵³⁷. An Independent Power Producers' Association of Nepal official said, "We told him [the Indian ambassador] that Nepal's private sector would be encouraged if India agreed to buy the power generated by Upper Tamakoshi. But the ambassador said Nepal could propose other projects instead of Upper Tamakoshi"⁵³⁸. In response, the managing director of NEA, Kulman Ghising, has said that although Nepal has noted Indian concerns, "how can we control contractors on projects that are selected by global bidding?... In hydro-power civil construction, there are very few Indian or European contractors that can compete on cost." Separately, he told an Indian newspaper, "If [Upper Tamakoshi] had been cleared [by India], we would have been exporting 800 MW of hydro-power last year. We agree that since this is an Indian policy for investment, we don't submit those projects in Nepal that have [investment from China]. But contractors cannot be restricted"⁵³⁹.

Beset by a geopolitical issue out of its control, Nepal has also faced issues with the construction of transmission lines from the Upper Tamakoshi project to Kathmandu valley. Although the transmission lines were to be completed by 2019, NEA cancelled the contracts awarded to a Chinese JV of Guangxi Transmission and Substation Construction Company and Shenzhen Clou Electronics in 2020, citing slow progress. A new procurement process was initiated, and the contract was awarded to Indian company Larsen & Toubro Ltd in November 2020. But immediately, locals began to protest and did not allow the Indian company to build a substation at Lapsiphedi. NEA officials alleged the protests were backed by ulterior motives and that there were no protests when the contract had been awarded to the Chinese company. NEA officials also said the land acquisition process had been completed and the protestors were those who had no connections with the transmission line route^{540 541}. Although an agreement was reached with the protesting locals, the issue remains ongoing⁵⁴².

In February 2023, NEA shortlisted two Chinese contractors for the civil works component of the Tamakoshi V hydropower project, which is a run-of-the-river project being developed as a cascade unit of Upper Tamakoshi and will take water directly from the latter's tailrace tunnel⁵⁴³. The two shortlisted Chinese contractors are Sinohydro and China Gezhouba Group Corporation, but the final contract has not been awarded as of writing. The project is estimated to cost NPR 18.5 billion, with 70 percent being funded by a loan from the Employees' Provident Fund, and the rest as equity. The project will be constructed under an EPC model, and bids for the electro-mechanical component will be invited later⁵⁴⁴. The

Asian Infrastructure Investment Bank has also provided a grant of USD 900,000 to look into environmental guidelines of the project⁵⁴⁵.

The Upper Tamakoshi Project has been hailed as Nepal's Three Gorges but transnational electricity trade has been stuck because of geopolitical tensions beyond Nepal's control. India's reluctance to buy power from the project due to Chinese involvement in construction may provide a future template both for Delhi and Kathmandu, especially as the latter decides to continue awarding new contracts to Chinese companies and contractors. A resolution to this issue will be critical for Nepal's hydropower export dreams in the years to come as more projects become operational. Nepal is also seeking to export power to Bangladesh by using Indian transmission lines, a process that will certainly boost regional connectivity and Nepal's export earnings. But whether India will allow the transmission of power from plants which have Chinese involvement in any form – whether as contractors or as investors – is a question that Nepal will need to seek an answer to very soon.

India has refused to comment on the issue so far, but its reluctance to not engage with any Nepali infrastructure works with Chinese involvement in any form is said to extend to the two airports built by Chinese contractors in Bhairahawa and Pokhara⁵⁴⁶. Similarly, India has also asked Nepal to provide end-use certificate for the explosives it provides, which has been read as India seeking to control the explosives required for infrastructure projects with Chinese involvement. Nepali officials have said several infrastructure projects – such as the Prithvi Highway expansion and the Tanahun hydropower project – with Chinese contractors have been delayed because of India's tacit decision⁵⁴⁷.

If so, Delhi seems to have decided to deny market access in any form to Chinese companies via Nepal, which China had originally envisaged as one of the key goals of the Trans-Himalayan Multidimensional Connectivity Network under the BRI. India's reluctance on these issues has also been seen as another way in which it has exercised its economic leverage over Nepal.

Nonetheless, Chinese contractors are involved in several hydropower projects and transmission line construction all across Nepal under the auspices of the NEA. A list based on NEA's 2021-22 annual report is as follows⁵⁴⁸:

Table 3. Chinese Involved Hydropower Projects and Transmission Line in Nepal

Project name	Contractor	Nature of works	Source of funds	Value of contract	Cost estimate
60 MW Upper Trishuli 3A	China Gezhouba	Replacement of equipment			
Chilime-Trishuli 220 KV Transmission line	Pinggao Group Co. Ltd	transmission line construction	KfW +EIB+ EU+GoN	US\$ 6,884,897.67 + NPR 722,555,332.49	
Chilime-Trishuli 220/132/33 kV substation	Pinggao Group Co. Ltd	substation construction	KfW +EIB+ EU+GoN	US\$ 6,432,900.86 + NRS 547,472,116.35	
Trishuli 3B 220 kV HUB substation	Pinggao Group Co. Ltd	substation construction	GoN+KfW +EIB	USD 12.5 million	USD 16 million
Bharatpur-Bardaghat 220 kV Transmission Line	Central China Power Grid International Economic & Trade Co. Ltd, China (CCPG)	transmission line construction		contract terminated in June 2017	
Bharatpur-Bardaghat 220 kV Transmission Line	Hengton-Optics Electric Company, China	transmission line construction		USD 5.5 million	
132 kV substations at Hetauda and Bharatpur and bay extensions at old Hetauda and Bardaghat substations.	ZHONGDING INTERNATIONAL Co. LTD., CHINA	substation construction		contract value of USD 5.8 million terminated in April 2022	
Procurement of plant for 220 kV Barhabise GIS SS	JV of Guangxi Transmission & Substation Construction Co. and Shenzhen Clou Electronics Co. Ltd, China.				

Samundrarar-Trishuli 3B 132kV Transmission Line	ETERN-CCCE-FEPEC JV, China	EPC contract for substation and transmission line construction	EIB+ ADB [USD 12 million]		NPR 1.55 billion
Marsyangdi Corridor 220 Transmission Line Project	Pinggao Group Co. Ltd [first package]	construction of about 67 km of 220 kV, a double circuit transmission line with twin ACCC Drake conductors from Udipur to Bharatpur.			
Marsyangdi Corridor 220 Transmission Line Project	TBEA Co., Ltd, China. [third package]	construction of the transmission line from Dharapani to Udipur			
Marsyangdi – Kathmandu 220 kV Transmission Line Project	China Machinery Engineering Corporation, China [contract awarded after termination with Shenzhen Farad Electric Co.]	construction of 220/132 Substations of capacity 320 MVA at Markhichowk and 320 MVA (2*160 MVA) at Matatirtha.			
New Butwal – Bardaghat 220 kV Transmission line and Substation Project	POWERCHINA SEPCO1 Electric Power Construction Co. Ltd.	21 km of 220 kV transmission line from New Butwal to Bardaghat			
Kathmandu Valley Transmission Capacity Reinforcement Project	Pinggao Group Co. Ltd	three new 132/11 kV GIS Substations, 2x45 MVA each at Chobhar, Phutung and Thimi.			

Construction of 132 kV Pangtang Substation	M/S CQNEC-NHE JV, Nepal [JV between Chongqing New Century Electrical Co., Ltd. and Nepal Hydro and Electric Ltd]	construction of substation			
102 MW Middle Bhotekoshi Hydroelectric Project	China Energy Engineering Group Guangxi Hydroelectric Construction Bureau (CEEC GHCB) Co. Ltd., China	EPC contract for civil and hydro-mechanical works			NPR 15 billion
111 MW Rasuwagadhi Hydropower Company Limited	China International Water and Electric Corp. (CWE)	EPC contract for civil and hydro-mechanical works			

Source: NEA Annual Report 2021-22

As a KI involved with a private think-tank said, many smaller Chinese contractors are active in NEA projects across Nepal. “They have local support and work on low costs. But the flip side is that there is no communication with locals, and the environmental impact is not always a concern, although the latter is not necessarily due to the contractors themselves.”, he said.

Chinese investment through the private sector in Nepali infrastructure

Subsequent to China’s political and economic outreach through bilateral means in Nepal, Chinese companies have emerged as the largest source of FDI pledges in the country since 2015, and Chinese contractors are involved in several private-sector hydropower projects in particular. Chinese investments within Nepal can mostly be seen within three major sectors: infrastructure, construction and tourism. Within these sectors, Chinese investment and engagement can be mostly identified within hydropower development, cement industries, aviation and mining. Between 2008 and 2018, around half of the USD 673 million in Chinese private investment in Nepal was in 13 projects in the hydropower sector⁵⁴⁹.

China and/or its companies committed USD 188 million in FDI in Nepal in FY 2020-21, with 140 new investment projects registered with the Department of Industry⁵⁵⁰. In 2019-20, of the 227 new FDI projects approved, 176 were backed by Chinese investors at an

estimated value of NPR 26 billion⁵⁵¹. According to the Department of Industry statistics 2021-22, China had emerged as the largest foreign investor in Nepal, with 2,111 FDI projects registered at a value of NPR 21,660 crores, or USD 1.6 billion⁵⁵². India was second with 819 projects registered at a value of NPR 10,100 crores, or USD 770 million.

Table 4. Top 10 Countries on the Basis of Foreign Investment in Industries (Up to FY 2078/79)

S.N.	Country	Number of Projects	Total Amount of Foreign Investment (Rs. In 10 Crore)	No. of Employment
1.	China	2,111	2,166	11,128
2.	India	819	1,010	74,303
3.	USA	438	156	19,687
4.	South Korea	362	128	12,094
5.	British Virgin Islands	17	11	2,326
6.	UK	196	80	11,440
7.	Singapore	56	75	3,816
8.	UAE	24	38	1,931
9.	Japan	278	34	10,521
10.	Others	1,181	357	52,179

Source: Department of Industry Industrial Statistics 2021-22

As Chinese investment has grown in recent years, so has the presence of its enterprises. However, there has not been a uniform and systematic documentation of the number of SOEs in Nepal and their place of origin. For instance, the MOFCOM report⁵⁵³ states that as of 2019, there are 18 Chinese SOEs present in Nepal. Yet, there are, as estimated, more than 60 enterprises currently in Nepal⁵⁵⁴. One of the earliest SOEs to enter Nepal was Power China in 1972 for the construction of Sunkoshi hydropower project which was presented as a “gift” to Nepal. A lot of well-known SOEs in Nepal are primarily newly established or started investing overseas with desire to maintain strong international presence. For instance, the largest FDI based industrial project in cement factory undertaken by Hongshi cement started implementing “going global” strategy in 2013 with its first 5 large-scale cement industry projects being in: Myanmar, Nepal, Indonesia and Laos⁵⁵⁵. Similarly, in terms of transportation infrastructure, the company that expressed its interest in building the railway from Kerung to Kathmandu i.e., China Railway Construction Co. Ltd. was only established in 2007 and was previously the railway arm of the PLA⁵⁵⁶.

SOEs from China face increasing competition among themselves for overseas infrastructure projects. For instance, the overseas department of the Zhejiang Group called on Xie Yu, the Economic and Commercial counsellor of the Chinese Embassy in Nepal in November 2022, highlighting the challenge of complex international environment and intense competition among provincial state-owned enterprises for contracts overseas⁵⁵⁷. While provincial SOEs leverage to gain influence from the Chinese Embassy and MOFCOM in host countries, larger SOEs can have significant influence with direct contacts with the ministers. For example, in 2010, during then Prime Minister Madhav Kumar Nepal's visit to China, the President of China National Electric Engineering Co. (CNEEC) was invited to pay a personal visit to Nepal in discussion with prospects of CNEEC to "further continue to participate in Nepal's infrastructure construction"⁵⁵⁸. A KI stated that most large SOEs tend to exert their own influence with their own channels in respective ministries in Nepal bypassing the Embassy.

Chinese enterprises in Nepal

Chinese participation in Nepal's hydropower sector is most visible, but its experience has been relatively new compared to other countries. The Upper Marsyangdi A hydropower project, built under the BOOT model was the first project funded and constructed by Power China Resource Ltd and the first hydro project funded and built by a Chinese company in Nepal⁵⁵⁹. A 2022 agreement between Gezhouba Group and Apollo private energy company (a project affiliated with the Nepal-based Golyan group) was signed for the construction of a 260 MW hydropower in Mugu district under the EPC framework⁵⁶⁰.

Nepal has seen large FDI from China in the cement manufacturing sector, with Hongxi investing USD 251 million in a joint venture with Shivam Cements, and Huaxin investing USD 140 million with Narayani Cements. The most prominent Chinese investment in Nepali private sector aviation is Himalaya Airlines, a joint venture between Nepal's Yeti World Investment Pvt Ltd (a subsidiary of Yeti Group, which runs Yeti Airlines and Tara Air domestically in Nepal) and China's Tibet Aviation Development & Investment Company Ltd.⁵⁶¹ Yeti World owns 51 percent stake in the USD 25 million company, Tibet Aviation owns 49 percent. The company was set up in 2014, with Nepal's Himalayan Infrastructure Fund (HIF) jointly owning the 51 percent stake along with Yeti World⁵⁶². According to its financial statements, HIF sold off its stake in the airline in 2017-18⁵⁶³.

Himalaya Airlines made headlines when then Prime Minister K.P. Oli decided to fly to China on his landmark 2016 visit on the same airline. India has not permitted the airline to fly to Indian sectors due to its ownership structure being unclear⁵⁶⁴. The airline has also come in the news for its political links, with reports in 2020 suggesting Nepal's aviation authority CAAN had directed state-owned Nepal Airlines to hand over ground handling

services to Himalaya⁵⁶⁵. The same report also suggested the airline had been preferred over the state-owned airline for repatriation flights during the Covid-19 pandemic.

The airline also ran chartered flights from the newly constructed GBIA, and also carried out the inaugural test flight at the Pokhara International Airport. Reports suggest the airline has been given the ground handling contract at GBIA and self-ground handling services at the Kathmandu airport⁵⁶⁶.

Challenges for Chinese enterprises in Nepal

As Chinese companies have entered Nepal at an increasing rate in the recent years, it has also induced numerous challenges that have garnered debates. Among the infrastructure projects in lieu of Chinese engagements, Pokhara International Airport has remained the significant one. In 2012, Times of India reported that the MoU for construction of the airport was “quietly signed between the Government of Nepal and China CAMC Engineering Co Ltd. owned by PRC”⁵⁶⁷. In response, the Ministry of Foreign Affairs (MOFA) of China on October 10, 2012 responded by assuring all investment and engineering contracts would abide by Nepal’s local laws and regulations. Facing outright criticism, China CAMC in a rare interview on October 15, 2012 said:

*“In the process of Chinese enterprises Going Global, they will inevitably touch the political and economic interest of certain countries. Therefore, it is often seen that some media question and criticize the legal and business activities of Chinese enterprise, and even deliberately smear at them. Although we often saw negative reports on Chinese companies from foreign media in the past, this is the first time that our company has been distorted by the media.”*⁵⁶⁸

It’s not the first time that news reports have proved to be troublesome for the Chinese enterprises in Nepal. In 2019, after the Public Procurement Monitoring Office, acting on complaints from NEA, blacklisted three Chinese companies, namely Shenzhen Farad Electric, Huizhou Zhongcheng Electric Technology, and Central China Power Grid International Economic & Trade⁵⁶⁹. While Huizhou Zhongcheng was found to have submitted fake documents in its bid to revamp the Kathmandu valley smart metering project, the other two companies were blacklisted for non-performance. China’s MOFCOM then issued a note of “advice” to Chinese enterprises in the country saying, “Some Chinese companies entering Nepali market for the first time often won bids at lower prices under the misguided guidance of the Nepali agent due to insufficient market research and lack of awareness of risks, resulting in difficulties in contract performance”⁵⁷⁰.

Procurement risks in Nepal garnered significant discussion before the pandemic in China. Towards the end of 2019, the China Entrepreneurship Forum discussed the risks of

contracting projects in Nepal. The forum highlighted five risks for Chinese enterprises when operating in Nepal⁵⁷¹: 1) terms of contract that can be modified 2) the concept of “lowest-bid winning” which not only results in lower quality but also fluctuation of prices and later increases costs and burden; 3) agency risks i.e., having to rely on Nepali agents that have potential to carry out fraudulent activities for profit; 4) labour risks with Nepali workers as compared to Chinese workers and uncertainty in construction efficiency; 5) natural calamities and frequent disasters posing significant challenges and resulting in construction delays.

However, some Chinese scholars have openly commented on the Chinese enterprises’ approach in Nepal, arguing for the need to focus on project development stages, and improving active communication and negotiations with host country and state: “Some enterprises track projects independently, actively follow up if there are suitable projects, and avoid them if there are no suitable projects. This is a completely wrong approach. For the hydropower market in Nepal, only by fully understanding the market conditions can scientific judgements and decisions can be made”⁵⁷². In this regard, Chinese approach in Nepal has been more project-driven as opposed to market-driven. In order to make its overseas projects more sustainable, MOFCOM in 2019 came up with the Belt and Road debt sustainability framework (DSF) focusing on strengthening risk management mechanisms of its overseas projects. While the World Bank and IMF’s DSF advise a limit on non-concessional loans for countries with high debt stress, China’s DSF approach still remains voluntary for enterprises while still requiring the need to incorporate project and social risks⁵⁷³. Having said so, China still possesses enormous challenges in ensuring sustainability of its projects across various enterprises in recipient countries.

CHAPTER III

Malpractices in Infrastructure Governance in Nepal

Summary

Public procurement in Nepal is aimed at ensuring transparency, impartiality, and competitiveness. However, corruption remains highly prevalent in public procurement in Nepal. Collusion between the private sector, political parties, government officials, and state institutions contributes to corruption fuelled by impunity.

Conflicts of interest and lack of transparency plague the procurement process, with political considerations often influencing decisions on what to procure, whom to procure from, and how to procure. This applies both to contracts awarded to domestic and international contractors, as well as in domestically funded and internationally funded projects. Complicity between the private sector and government further exacerbates issues in the infrastructure sector, including delays, cost escalations, poor contract management, and substandard implementation. Contractors disappearing mid-work, fines for delays, and blacklisting followed by re-awarding contracts are common.

Local representatives, often with close ties with the political class, play a significant role in securing international contracts for foreign companies. Amendments to the procurement act and regulations, frequently influenced by political affiliations, further undermine the integrity of the process. Large contracts are divided among specific Nepali construction companies to ensure they benefit from the projects, and factors like bid quality and project management skills are overlooked. Embezzlement of funds through bribery and inflated project costs is a major concern. Time overruns and substandard work are common due to corruption and political interference.

Ambiguities in Public Procurement Process in Nepal

Public procurement in Nepal refers to the process by which the GoN or any public entity purchases goods, works, construction and consultancy services⁵⁷⁴. The process is currently overseen by the Public Procurement Act (PPA), 2007, which on paper intends to guarantee transparency, impartiality, and competitiveness in the procurement process⁵⁷⁵. This applies to all government departments, and whether procurement is intended to be domestic or international.

Public procurement in Nepal begins with the identification of the required goods, works, or services. The procuring agency then prepares a procurement plan and invites bids from interested suppliers or contractors. The bids are evaluated based on predetermined criteria, and the contract is awarded to the most qualified bidder, generally the lowest bidder known as L1⁵⁷⁶.

Several types of procurement methods have been used in Nepal, including open competitive bidding, selective bidding, and negotiated procurement⁵⁷⁷. The choice of procurement method depends on the essence and complexity of the procurement and the availability of competition.

The PPMO is responsible for monitoring and enforcing compliance with the PPA⁵⁷⁸. The PPMO has the authority to cancel procurement proceedings if they are found to be non-compliant with the Act.

To make the procurement process legally binding and fair, bidders are required to submit their bids by keeping technical as well as the financial proposals in two separate envelopes that are to be sealed, each of which must clearly identify which proposal it contains, before sealing both the envelopes in a separate outer envelope.

For construction projects, the PPA of Nepal 2063 promotes awarding contracts to the lowest bidder. However, this approach has a potential downside, as contractors may submit unrealistically low bids that result in quality issues, disputes, increased costs, and delays. Studies from elsewhere in South Asia have shown that selecting the lowest bidder may lead to a disincentive for contractors to prioritize quality, as they may employ low-cost materials and forego hiring equipment to minimize expenses⁵⁷⁹. Such an approach may also not result in the most competent and efficient contractors being selected, which can affect the optimal value for money. Multiple KIs who have been involved in procurement both inside and outside the GoN identified this as the root cause behind project delays and implementation issues. Thus, alternative procurement methods that consider technical capability, experience, and risk management, in addition to cost, should be considered to achieve better project outcomes.

The PPA was later amended to discourage the practice of selecting contractors who submit unrealistically low bids by mandating bidders who propose prices below 30 percent of the estimated cost to provide a justification for the low bids⁵⁸⁰. However, continued prevalence of shady practices in awarding contracts, suggests this amendment has not been effective in achieving the intended results.

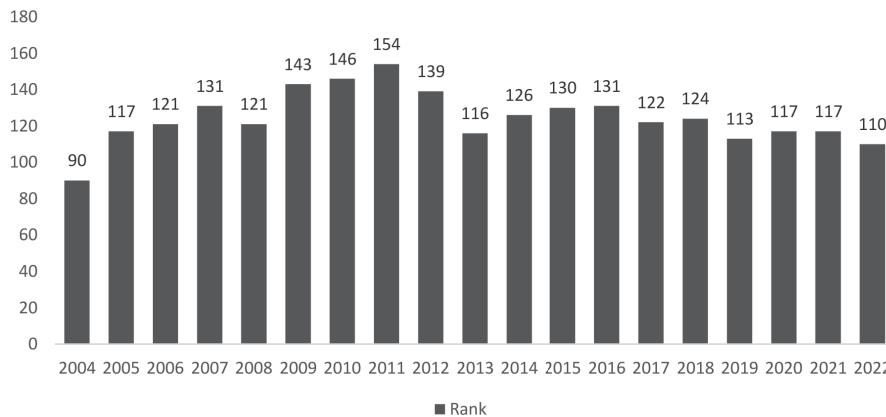
Public procurement laws in Nepal establish several measures to ensure the best outcome for money, including but not limited to:

- The use of competitive bidding, including open tendering and limited tendering, as the primary method of procurement.
- The establishment of a Public Procurement Monitoring Office (PPMO) to oversee the procurement process and ensure compliance with the laws⁵⁸¹.
- The use of electronic government procurement (eGP) systems to improve transparency and reduce the risk of corruption⁵⁸².
- The requirement for the publication of procurement notices, bid documents, and other relevant information in a public forum, such as a website or newspaper⁵⁸³.
- The establishment of a dispute resolution mechanism, including the possibility of seeking remedies through the courts or other legal remedies⁵⁸⁴.

Overall, public procurement laws in Nepal intend to create a level-playing field for all potential bidders and to ensure that public funds are used efficiently and effectively. By following these rules and procedures, government agencies and other public bodies can help to reduce the risk of corruption and improve the quality of services, goods, and works procured. However, public procurement in Nepal has been vulnerable to corruption, particularly when there are conflicts of interest, a lack of transparency, or inadequate oversight⁵⁸⁵. This is most reflected in Nepal's global corruption rankings.

Nepal's ranking of 110 out of 180 countries with a score of 34 on the Corruption Perception Index 2022 indicates that the country is classified as a highly corrupt nation, as a score below 50 is suggestive of a high prevalence of corruption⁵⁸⁶. Although Nepal improved a bit compared to year-on-year, Nepal has consistently been placed among countries with high prevalence of corruption since 2006, touching a high rank of 154 in 2011⁵⁸⁷.

Figure 2. Nepal's Rank on Corruption Perception Index Over the Years



Source: Transparency International Corruption Perceptions Index, 2022

As a study on corruption in Nepal noted, “Corruption in Nepal is not a series of disjointed, individual acts. Instead, a range of stakeholders spanning public, private, and criminal spheres operate as one to steal money from the people and ensure impunity thrives. This kleptocratic network is made up of shifting alliances, which span multiple communities that are inter-connected by several powerful businesspersons acting as brokers. The network is vertically integrated. Money flows upwards through the hierarchy while impunity and benefits flow downward”⁵⁸⁸.

Public procurement has been identified as among the most susceptible of government activities to corruption⁵⁸⁹. In Nepal, public procurement has seen a variety of corruption scandals that have emerged in the last decade alone, with corruption and collusion with private sector parties visible in the procurement of infrastructures (as discussed in case studies), vaccines, medical goods, and other vital supplies during the Covid-19 pandemic and the purchase of an Airbus 330 for its state airline, to name a few. Various types of corruption have been reported in the public procurement process in Nepal, including bid rigging, bribery, and fraud. Corruption has resulted in the awarding of contracts to companies that are not the most qualified or that offer substandard goods or services, leading to a waste of taxpayer funds and a decrease in the quality of public goods and services.

To combat corruption in public procurement, governments and public agencies implement measures such as increasing transparency, strengthening oversight and accountability, and establishing clear and fair rules for the procurement process. It is also important to ensure

that there are strong legal penalties for those who engage in corrupt activities related to public procurement. However, corruption persists with impunity in Nepal because of a wide nexus between the private sector, political parties, government servants, and state institutions. Very few corruption cases have led to punishment; instead, as a KI formerly with a multilateral institution said, “Bad behaviour is rewarded in Nepal.”

Despite the implementation of regulatory frameworks, the prevalence of risks in public procurement such as collusion, intimidation, and cartel formation among bidders in Nepal appears to be on the rise at both central and district levels⁵⁹⁰. Reports have surfaced suggesting that a tradition has developed among government officials in Nepal of demanding ‘signing amounts’ prior to approving contracts for development projects⁵⁹¹. In particular, the Ministry of Physical Infrastructure and Transport has become a nodal point and “attractive revenue stream”: “Collusion between senior government officials and contractors, combined with careful packaging of contracts limits competition and favours certain contractors. Contract costs are often inflated, often by more than double”⁵⁹².

A KI associated with a research body emphasised that the formal decision-making space in Nepal remains informal by nature, inferring that Nepal’s bureaucracy is not process-oriented. Although such informality within the decision-making process cannot be quantified, it is widely seen not just in public procurement and bureaucracy, but also in political decisions. The formal system of procurement, although practiced by the rule, is thus often secondary to the informality within the system.

Nexus between politics and private contractors

Because the GoN is one of the largest buyers of goods and services, and the procurement process involves large sum of money, political considerations often come into play when decisions are made about what to procure, who to procure from, and how to procure. This has resulted in cross-cutting conflicts of interest that has allowed corruption to proceed with impunity.

For instance, the issue of private contractors running for federal and provincial governments in Nepal from the mainstream political parties has raised serious concerns about the integrity of government procurement processes and the overall completion of the infrastructure project. The Federation of Contractors' Associations of Nepal (FCAN), an organization comprising of builders and contractors, revealed that 13 of its members vied for seats in the federal parliament and 15 in the provincial assemblies in the 2022 elections⁵⁹³. The desire for power and authority is not limited to higher-level elections, as the trend is also observed in local elections. FCAN reported that in the local elections held in May 2022, more than 236 contractors secured positions in different local units, with about 50 of them winning the top executive positions⁵⁹⁴.

Further, Bikram Pandey, a contractor who had been cleared of corruption charges related to the Sikta irrigation project by a Special Court⁵⁹⁵, was appointed as the urban development minister by PM Pushpa Kamal Dahal (Prachanda) in 2022⁵⁹⁶. Pandey, who is the head of Kalika Construction, an 'A' category contractor, had won as a member of the House of Representatives from Chitwan-3 constituency on the ticket of the Rastriya Prajatantra Party, a monarchist party. A former minister of forests, he was among the 21 individuals who were acquitted of corruption allegations in the Sikta project in June 2022⁵⁹⁷. Further, when Pandey was minister, Kalika Construction sought an extension on its own contract's deadline, raising concerns regarding a possible conflict of interest⁵⁹⁸. Kalika Construction has got public works contracts worth NPR 5 billion in the past five years, but hasn't completed any of them.

Pandey's appointment, given his background as a contractor and his prior legal entanglements over corruption allegations, is a clear instance of both the conflict of interest as well as the collusion between the business of infrastructure and government. The Ministry of Urban Development's decision to potentially grant Kalika Construction additional time to find a partner to fulfil its contractual obligations has led to questions about whether the minister is using his position for personal gains. Such a situation could raise ethical and regulatory concerns, and prompt investigations into the matter. These developments highlight the importance of transparent and accountable governance practices, particularly in sectors such as construction and infrastructure where there is a high potential for conflicts of interest. The case of former minister Pandey also highlights the potential risks and ethical concerns associated with contractors entering politics, which could undermine public trust and necessitates transparent and accountable governance practices.

The infrastructure sector on the other hand suffers from multiple issues due to the prevalence of collusion between the private sector and government. Delays, cost escalations, contract management, political interests intersecting with project implementation, land acquisition issues (often arising out of local political interests – as a KI stated, in the Nagdhunga tunnel project under construction by a Japanese company, the ward chairperson was leading the land acquisition struggle committee. “Regardless of his party affiliation, he won't do as other higher leaders ask him to do as he has his own economic interests.”), and even outlandish implementation – local units have built bridges where there are no roads⁵⁹⁹ – are commonplace enough. Faulty design has led to bridges being declared unfit for traffic even before they were used – in one instance, a bridge built in the heart of Kathmandu city by a former MP, who went to jail for embezzling NPR 193 million along with his son⁶⁰⁰. Local highways under construction have seen the contractor disappearing mid-work⁶⁰¹, fines for delays are common⁶⁰², and companies are regularly blacklisted – but they can bid again after a certain period of time⁶⁰³.

A further element in this nexus of collusion, especially with respect to international contractors, is the local representative, otherwise known as ‘agents’ in local parlance. These representatives are officially private sector individuals who work on the basis of commissions on tender amounts, or supply goods and services to the project. However, as our case studies show, several representatives have close links with the political class, either familial or social. All the KIs identified local representatives as key factors in securing international contracts. “Private sector actors and proxy-capitalists bribe civil servants to engage in policy corruption, offering kickbacks and commissions in return for help in winning contracts, implement tax avoidance schemes, and obtain licences and permits. Private actors also finance candidates in elections and the promotion or appointment of their civil servant clients... Private sector kickbacks and commissions are common across key revenue areas, including remittance, telecom, banking, finance, insurance, real estate, education, health, transport and the extraction of natural resources, and is particularly the case in ministries with high development expenditure. Contractors engaged in the construction of infrastructure—especially roads—are some of the key private sector actors within the kleptocratic network”⁶⁰⁴.

Politically affiliated people have been manipulating and amending the procurement act and regulations frequently to please and favour businessmen and contractors. The current Procurement Act underwent its 11th amendment on 25 March 2022 and again for the 12th time on 4 July 2022, where arrangements were made to allow Nepali contractors to enter into contracts worth up to five billion rupees⁶⁰⁵. Adding to it, in order to have lesser competition among bidders and to land a particular project to their networks, the procurement process often ends without a proper examination of all the bid documents.

In an instance, the Suryavinayak-Dhulikhel road contract worth NPR 9 billion was split into two packages of NPR 4.5 billion each to award the contract in a setting with some domestic contractors. The former Minister of Physical Infrastructure, Mohammad Istiyak Rai was responsible for the revision⁶⁰⁶. Lama Construction was awarded the contract to complete 8.4 km of a 15.5 km road expansion project from Sanga to Dhulikhel in the first phase. The contract was worth over Rs 4.5 billion. In the second phase, the Ashish-Kumar Sharestha-Bandan Bhagwati JV was awarded the contract to complete a 7.5 km stretch of the Suryabinayak-Sanga Road at a cost of over Rs 3.8 billion⁶⁰⁷. News reports suggest that a minimum of five percent of the funds acquired through this arrangement was shared as a kickback among the Minister and the PMO⁶⁰⁸. Factors like the quality of the bids, the skills and experience of the bidders, and the ability of the project management team to effectively execute the project are overlooked while finalising the contractors. Unethical practices such as favouritism towards specific bidders, manipulation of bid prices and corruption in awarding of the contracts have been found to be deeply rooted in Nepal's public procurement process.

A major concern in Nepal is the embezzlement of funds from development projects by locals and officials at the local level for personal enrichment. Two hydropower projects, the 24-MW Madame Khola and the 6.6 MW Garjyang Khola, situated in the Madi Rural Municipality, were impeded by local officials who demanded hefty donations for themselves and their party's cadres, serving as a grim reminder of the rampant practice of corruption in public works in Nepal⁶⁰⁹. This is typically achieved through corrupt practices such as bribery, embezzlement, and kickbacks. In some cases, locals and local officials may collude to inflate project costs and divert funds for their personal gain. This can be achieved by inflating the prices of materials and services procured, or by submitting fake invoices and receipts to claim payments for work that was not performed.

Investors obtain licenses as per requirements set by the federal government and are also required to fulfil the requirements set by local bodies. Investors face inappropriate conditions from local officials to initiate work which has become a major challenge in most of the development sites of Nepal. Such inappropriate conditions include demands for bribes, kickbacks, or other forms of payment in exchange for allowing work to proceed or expediting the process; signalling the corruption being rooted deeply even in small projects and the involvement of locals.

These inappropriate conditions not only undermine the investment climate in Nepal and discourage both local and foreign investors from pursuing development projects, but also results in delays, increased costs, and reduced quality of work, ultimately affecting the effectiveness of development projects and the benefits they bring to the local population.

Although international infrastructure contracting – primarily those funded by multilateral institutions such as the World Bank and the ADB – are monitored better due to the funding institutions' norms, there are instances of collusion between the local representative, government officials and politicians in infrastructure projects that are handed over to foreign contractors, as our case studies show. In the Melamchi drinking water project, the foreign contractor admitted to paying off government functionaries by routing it via their supplies subcontractor⁶¹⁰. "Contract management has always been poor in Nepal, despite several attempts of improvement... There are skewed incentives on both the government and the donor side," one KI said. The KI, formerly with a multilateral institution, pointed out whether donor incentives or Nepali demand and political will were crucial in moving forward on a project. "Are you pulling or pushing the envelope? A small scale pull from the Nepali side can often push a project through," referring to the practice of moving ahead on donor-led infrastructure projects without adequate study. In international contracting, embassies often endorse low-quality companies here in Nepal, he said.

Another KI with a private research group said the procurement process involving Indian companies happens at a high political level due to the historical dependency that the Nepali market has on the Indian system. “Chinese companies are new and don’t have the same number of political constituencies like that of the Indians. But they are learning. A lot of effort has gone into building a Chinese understanding of how they should operate in the market place like Nepal. But that is not the same as the level of understanding that Indians have.”

Time overruns in projects are a common occurrence even in those executed by international contractors. Corruption and political interplay are among the main factors contributing to these overruns. National pride projects, such as the Melamchi water supply project, Arun III HEP, Kaligandaki HEP, West-Seti HEP, Budhi Gandaki HEP Kathmadu Ring Road Expansion, Postal Highway, Madhya Pahadi Lok Marga, Naryanghat-Butwal Road Expansion and Pokhara- Muglin Road Expansion have often come under public scrutiny due to prolonged delays⁶¹¹. The lack of transparency and accountability in the procurement process have led to substandard work and delays, ultimately leading to increased costs.

CHAPTER IV

Neighbours and Partners: Comparative Analysis of Chinese Infrastructure Engagement in Nepal vis-à-vis Japan and India

Summary

Nepal has received substantial aid from various countries for infrastructure development. Over the years, India, Japan, the US, China, and Soviet Russia, have led in funding and executing infrastructure projects in Nepal. However, the dynamics and patterns of aid provision have evolved over time, with shifts in focus and engagement from different countries.

Initially, India played a crucial role in Nepal's infrastructure development by extending assistance in major infrastructure projects like the Tribhuvan Highway, Tribhuvan International Airport, and several hydropower plants in the 1950s and 1960s. However, the political relationship between Nepal and India has influenced the perception and implementation of Indian infrastructure assistance. The 2015 blockade strained bilateral ties, but India has continued to promote regional connectivity by initiating new infrastructure projects in various sectors. Under Prime Minister Narendra Modi's assertive foreign policy, India has expressed concerns about China's increasing engagements in Nepal's political and infrastructure spheres and decided to block market access to Chinese companies and contractors via Nepal.

India's Official Development Assistance (ODA) programme is closely aligned with its foreign policy objectives in its neighbourhood. The majority of India's assistance in its neighbouring countries, including Nepal, comes in the form of grants through Government to Government (G2G) mechanisms. India also utilizes Small Development Projects (SDPs) to oversee grants implemented at the local level. The Line of Credit (LoC) facility is India's preferred lending instrument, executed through the Indian EXIM Bank, and has provided significant funding to various countries, including Nepal.

Japan emerged as a critical bilateral partner in Nepal's infrastructure ambitions since the 1970s, offering technical expertise, concessional loans, and grant assistance. Japan's Official Development Assistance (ODA) programme operates on the "request principle," wherein Japanese aid is offered based on recipient's requests rather than donor proposals. Infrastructure development, particularly in the transport and power sectors, has been a primary focus of Japanese assistance in Nepal. Japanese assistance has also featured debt relief measures, whereby Japan cancelled Nepal's outstanding debts, highlighting the significance of this aspect in Nepal-Japan relations.

The US, through the Millennium Challenge Corporation (MCC) grant, has recently renewed its engagement in Nepal's infrastructure sector. The MCC grant, worth USD 500 million, was signed in 2017 but faced controversies during the ratification process. Domestic politics, fuelled by ultranationalist rhetoric and misinformation, influenced the opposition to the MCC. The MCC's introduction marked a shift in the American aid approach in Nepal, with a renewed focus on infrastructure development.

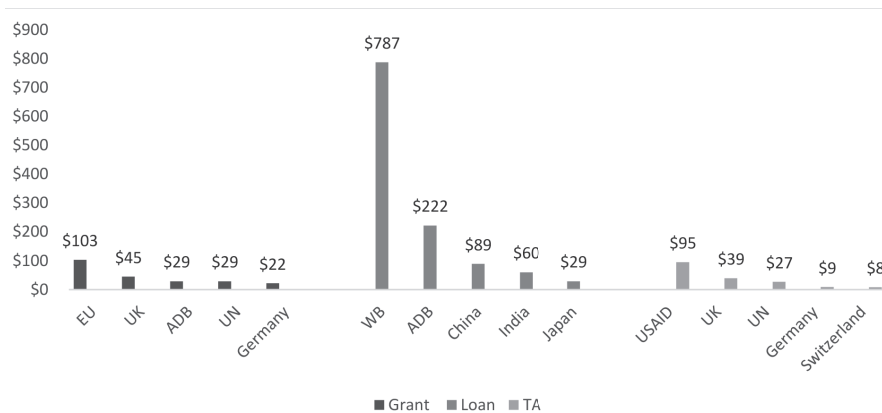
In terms of funding mechanisms, the share of loans as ODA has been increasing since 2014-15, largely driven by multilateral institutions shifting towards loan-based funding. The World Bank, Asian Development Bank (ADB), India, Japan, and China have been the major lenders, accounting for the majority of Nepal's loan-based ODA. Grant assistance, though still significant, has seen a slight decline compared to loans.

Nepal has been a net aid recipient for its entire history since 1950, with several countries funding infrastructure projects in Nepal. India was one of the first countries to build infrastructure projects, followed by the US, China, Soviet Russia and Japan. The US, however, withdrew from infrastructure projects from the mid-1960s onwards, and the Soviets also withdrew after funding a section of the East-West Highway. From thereon, as conversations with multiple KIs confirmed, India, Japan and China have been Nepal's primary bilateral partners in funding and developing infrastructure projects in the country.

Nepal received USD 1.6 billion in Official Development Assistance (ODA) in FY 2020-21, of which 66.89 percent was provided as loans. Grants made up 21.49 percent of total ODA in this period. Bilateral partners contributed 26.95 percent of total ODA. The

energy sector received the highest ODA share at 17.66 percent or USD 297.43 million, followed by the road transportation sector at 15.03 percent⁶¹². However, commitments in the road sector were higher at 23.96 percent, while the energy sector saw 20.53 percent of total commitments of the USD 1.8 billion commitment agreements signed by GoN in FY 2020-21.

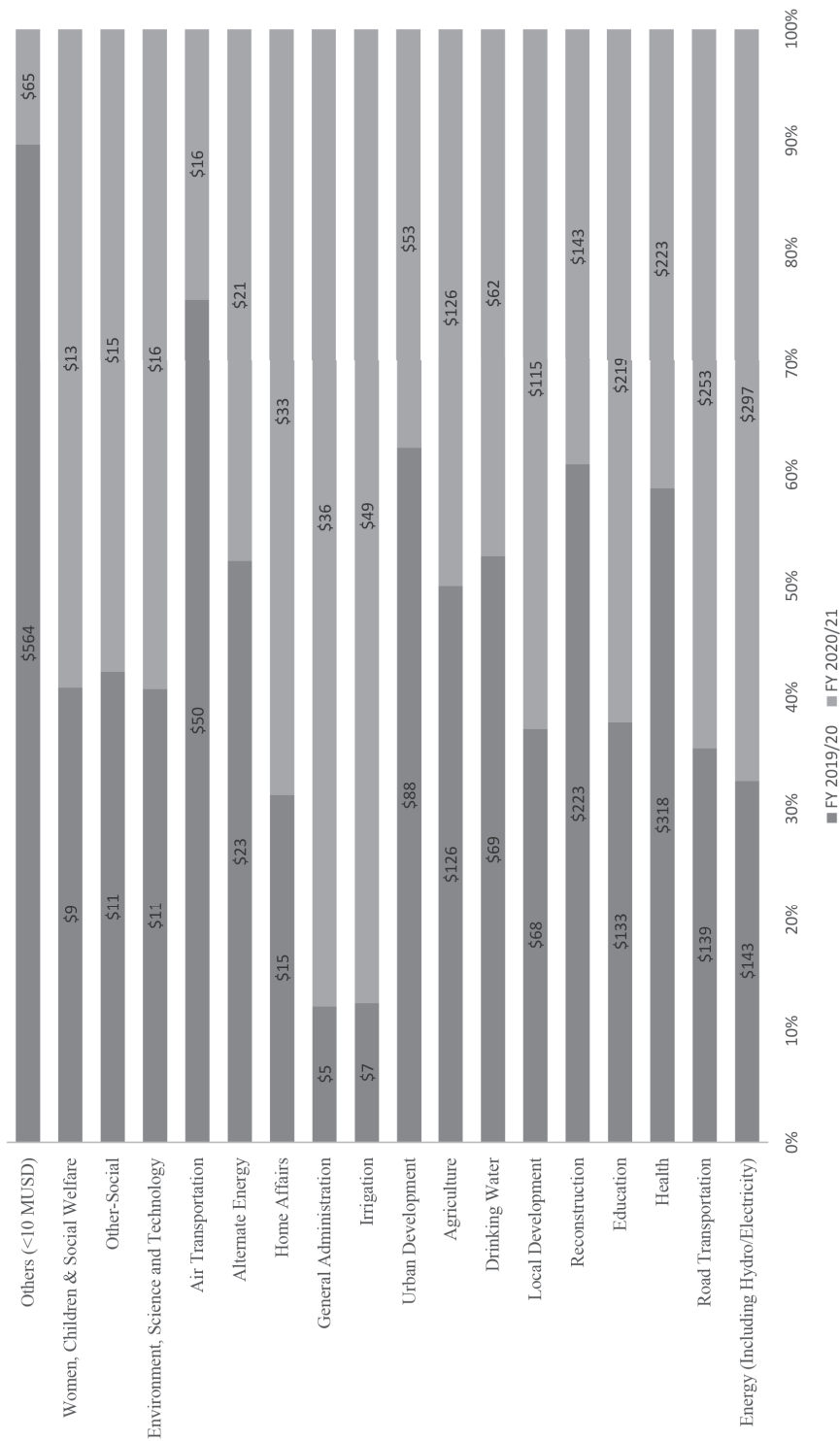
Figure 3. Top Five Disbursing Development Partners by type of Assistance, FY 2020/21 (in Million, USD)



Source: Development Cooperation Report 2020/21

The share of loans in ODA has been consistently increasing since 2014-15. This is because multilateral institutions, which contribute a large part of Nepal's ODA, have shifted towards loans as a funding mechanism. Of the loans, World Bank, ADB, India, Japan and China have provided USD 1.12 billion, or 99.44 percent of total loans. Sectorally, in the energy and road sector, the World Bank, ADB and Japan were the highest contributors. Although the US provided the largest bilateral ODA to Nepal at USD 106 million in FY 2020-21, it has invested more in social sectors such as health, education and agriculture. Similarly, the UK was the second-largest bilateral partner at USD 84 million, and has prioritized health, home affairs, education, and reconstruction.

Figure 4. ODA Disbursement by Sector, FY 2019/20 And FY 2020/21 (Million, USD)



Source: Development Cooperation Report 2020/21

Table 5. Development Partner Disbursements by Type of Assistance, FY 2020/21

DPs	Total Disbursement (US\$)				
	Grant	Loan	TA	In-kind Support	Total
ADB	29,388,221	221,666,838	-	-	251,055,059
Australia	4,496,808	640,419	-	-	5,137,227
China	14,089,551	22,992,099	-	-	37,081,650
EU	102,560,632	-	2,883,515	-	105,444,147
Finland	10,666,866	-	1535,520	-	12,202,386
GAVI	9,329,736	-	-	-	9,239,736
Germany	22,234,576	-	8,935,854	-	31,170,430
GFATM	3,015,332	-	-	-	3,015,332
IFAD	5,997,504	462,721	11,237	-	6,471,462
India	10,932,703	60,000,000	1,388,202	-	72,320,905
Japan	3,662,906	29,314,241	-	-	32,977,147
KFAED	-	797,826	-	-	797,826
Korea	1,307,304	-	6,817,679	-	8,124,983
Netherlands	-	-	1,322,302	-	1,322,302
Norway	21,868,100	-	-	-	21,868,100
OFID	-	4,277,126	-	-	4,277,126
Saudi Fund	16,593,151	175,254	-	-	16,768,405
Switzerland	16,715,254	-	7,682,455	-	24,397,709
UK	44,814,317	-	39,160,383	-	83,974,700
UN	28,973,528	-	27,410,955	-	56,384,483
USAID	7,314,746	-	94,654,596	3,971,866	105,941,208
WB	8,083,382	786,522,355	-	-	794,605,737
Total	362,044,617	1,126,848,879	191,802,698	3,971,866	1,684,668,060

Source: Development Cooperation Report 2020/21

Basic features of Chinese assistance in Nepal

Analysts have noted that the key features of Chinese aid in Nepal revolve around its institutional architecture, with the Chinese International Development Cooperation Agency (CIDCA) only being set up in 2018. CIDCA falls under MOFCOM but reports directly to the State Council⁶¹³. In Nepal, the primary driver of bilateral Chinese assistance is political. Nepal's assistance in suppressing the Tibetan exile movement has been key to Nepali security agencies receiving several aid grants from China. Where commercial interests dominate, such as in the unsuccessful Budhi Gandaki and the West Seti hydro projects or the successful PIA, China's political influence within Nepal's Communist parties remains a key driver of such interest in infrastructure. China's infrastructure development in Rasuwa and Sindhupalchowk districts, along with its assistance to the 15 northern districts bordering TAR, also lead one to argue that China is keen on securing its Tibetan frontier with Nepal. Rasuwa in particular has seen specific Chinese interest in infrastructures such as hydropower or the development of connectivity projects such as the proposed train from Tibet.

Chinese commercial interest are argued to drive its infrastructure engagement in several regions around the world, one can also argue since Chinese investment in Nepal has not grown at the same pace as its infrastructure engagements, commercial interest is not the primary driving factor in the country. Instead, geography and border management, along with political influence, often drive Chinese infrastructure engagements in Nepal. As a KI formerly with a multilateral institution said, "There is an unwritten understanding in multilateral institutions to not give projects in the Terai plains [closer to India] to China and projects in the mountains to India." However, with the ADB awarding the GBIA contract to a Chinese developer, this maxim has been broken.

Similarly, in terms of financing, apart from the PIA, there are very few projects that have been funded by China EXIM Bank directly. The Upper Trishuli 3A project and the purchase of Chinese aircraft are two other instances of China EXIM Bank financing. Due to lack of official statistics, it is difficult to break down the share of loans and grants in Chinese assistance in Nepal. However, Nepal's bilateral debt at the end of 2022 is 12.63 percent of its overall external debt, with outstanding debt to multilaterals making up 87.37 percent⁶¹⁴. Nepal owed China EXIM Bank RMB 1.8 billion or USD 287 million in this period, or about 28.7 percent of its outstanding bilateral debt.

Table 6. Donor wise Outstanding External Debt (in commitment currency, NPR & USD)

S. N.	Donor Type	Donor	Commitment Currency	Amount in Committed Currency	NPR Amount	USD Amount
1.	Bilateral	Belgium	EUR	5,564,691.3500	756,742,376.6865	6,384,933.9916
2.		EBK	KRW	63,161,266,000.0000	6,316,126,600.0000	53,291,652.0418
3.		EBLCI	USD	269,996,750.0500	32,000,014,815.9260	269,996,750.0500
4.		EIBC	CNY	1,826,848,986.8600	34,034,196,625.2018	287,159,944.5258
5.		JICA	JPY	40,559,412,212.0000	41,978,991,639.4200	354,193,314.5412
6.		Kuwait	KWD	2,947,881.0500	1,157,279,142.6090	9,764,420.7105
7.		NBF	EUR	2,225,583.6200	302,657,116.4838	2,553,637.4999
8.		Saudi	SAR	56,804,654.4200	1,793,890,986.5836	15,735,766.022
	Total				118,339,899,302.9107	998,480,419.3630

Source: Public Debt Management Office, 2022

The primary driver of Chinese engagement in Nepal’s infrastructure is its political linkages with Nepal’s communist parties, as seen from the case studies earlier. A broader political understanding with Nepal’s Left parties can be seen in China’s post-2008 engagement, which is also borne by the pace with which Communist-led governments have moved ahead on infrastructure projects developed or financed by China. As seen in the case of PIA and Budhi Gandaki, Chinese SOEs and companies identified projects in Nepal and sought the political assistance of its diplomatic mission in Kathmandu for such projects. The Chinese Embassy has been a constant in such big-ticket projects, as identified by several KIs who said that this was one of the key differences between Chinese and other missions with commercial interests in Nepal. Chinese companies have also been successful in reapplying to tenders where they have earlier been disqualified, as seen in the Fast Track Road Project developed by the Nepal Army. As a private-sector contractor and KI said, “Perhaps the Indian company that lost out on the contract did not have the sort of access that the Chinese company did.”

A key feature of Chinese engagement in Nepal’s infrastructure has been a lack of transparency and non-adherence to public procurement processes and laws, especially in bilateral projects. As seen in the case of PIA, Budhi Gandaki and West Seti, Chinese companies have signed MoUs that have bypassed public procurement laws, and Nepali politicians have in such cases either assisted them by converting such MoUs into cabinet decisions – such as in Budhi Gandaki – or facilitating a public procurement process wherein the selected company remains the top choice – as in the PIA project.

Table 7. Chinese Aid Disbursement During FY 2016/17 to 2020/2021 (USD)

S. N.	Fiscal Year	Aid Disbursed (in US\$) for Different Projects (Grant, Interest free loan and Concessional loan)
1.	2016/17	41,244,254
2.	2017/18	58,727,078
3.	2018/19	150,370,540
4.	2019/20	93,026,787
5.	2020/21	37,081,650

Source: Nepal Development Partner Profile Book, FY 2020/21

Former bureaucrats also note that negotiations with the Chinese are more difficult than with other bilateral or multilateral partners. As a KI formerly with the Planning Commission said, “It is difficult to negotiate with the Chinese because they do not let us in. If there is any negative feedback on a Chinese-led project, that person is blacklisted.” Most negotiations are held behind closed doors. The same KI said, “Chinese loans are problematic because of lack of transparency, which doesn’t happen with multilaterals. Chinese loans also turn out to be more expensive than declared. Chinese SOEs are also more accountable to their government than the host state. Such systems are designed to be corrupt. It may be okay within their system but it does not suit ours.” The KI also alleged that political parties preferred by the Chinese are funded through such projects. Similarly, another KI formerly with the Finance Ministry said, “The Chinese aren’t afraid to inflate costs.” Another KI formerly with a multilateral institution said, “If you compare bilateral projects, the Chinese also do not have a great track record in Nepal.”

Table 8. China's EXIM Bank Funded Projects (FY 2016/17 To FY 20/21)

S.N.	Project Name	Remarks
1.	Procurement of Aircrafts from China (1 MA 60 3 Y12E)	Completed
2.	Pokhara Regional International Airport	Ongoing
3.	Upper Trishuli 3A- Kathmandu 220kV Transmission Line and 132kV Line Bay Extension Works Project	Completed
4.	Upper Trishuli 3A Hydroelectricity Project	Completed

Source: Nepal Development Partner Profile Book, FY 2020/21

Indian engagements in Nepal's infrastructure sector

India was one of Nepal's earliest development partners in the infrastructure sector, building the Tribhuvan Highway, the Kathmandu Airport and other airfields, and a few hydropower plants in the 1950s and 60s. The political relationship between the two countries, however, has continued to shape both public perceptions as well as implementation of India's infrastructure assistance in the country. In the 21st century, although the 2015 blockade marked a low point in bilateral ties, India has continued to push for regional connectivity by implementing new infrastructure projects in different sectors. India's more assertive foreign policy under Prime Minister Narendra Modi has also resulted in Delhi expressing a clear displeasure at China's increasing engagements – both in the political and infrastructure spheres – inside Nepal.

Indian aid is budgeted under its Ministry of External Affairs (MEA), although it does not report the total volume of its aid to the DAC. In the 2023 Budget, India reduced its overall aid allocation by 2.6 percent from Indian Rupee (INR) 6,005 crore to INR 5,848 crore⁶¹⁵. A large proportion of Indian assistance flows to its neighbouring countries. Bhutan is the largest recipient of Indian assistance, with INR 2,400 crore earmarked for it in the 2023 budget. Nepal has been allocated INR 550 crore, a jump from INR 425 crore in the previous budget⁶¹⁶. Since 2012, India has been a net provider of aid, increasing its commitments to the UN as well as to African countries.

The MEA in 2012 created the Development Partnership Administration (DPA) wing within the ministry to oversee all aid projects. The DPA has three divisions, with DPA 1 handling projects and Line of Credit (LoC) facilities in Bangladesh; DPA 2 looking at technical and humanitarian assistance, and projects in Asia and Latin America; while DPA 3 looks at projects in Afghanistan, Maldives, Bhutan, Myanmar, Nepal and Sri Lanka⁶¹⁷.

A large portion of India's assistance flows as grants in its neighbourhood, usually through (Government to Government) G2G mechanisms. India also utilizes a 'Small Development Project' to oversee grants executed at the local level. India's preferred tool for lending is the LoC facility, which it executes using the Indian EXIM Bank. India's LoC facilities have extended USD 30.66 billion to 64 countries till date⁶¹⁸. Africa accounted for a majority of the LoC facilities, with LoC interest rates capped at 1.75 percent for low and low-to-middle income countries. Its post-disaster humanitarian assistance has been notable in the South Asian neighbourhood, especially after the 2004 tsunami and the 2015 Nepal earthquake. India committed USD 250 million in grants and USD 750 million in LoC for post-earthquake reconstruction in Nepal, and offered a USD 1 billion LoC to be utilized for development projects of Nepal's choice in 2014⁶¹⁹.

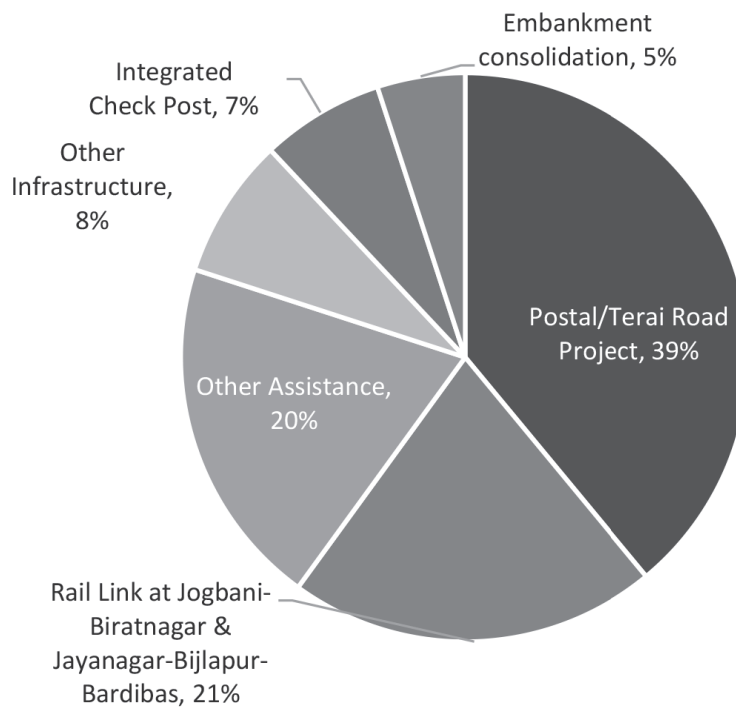
With India's ODA programme coming under its MEA, it's clear that India ties its aid to its foreign policy. Thus, aid programmes are designed in a manner that further India's foreign policy goals, especially in its neighbourhood. In the last decade, India has increasingly pushed for regional connectivity, investing in transport and energy infrastructure in several South Asian countries including Nepal, with almost half of India's assistance to its neighbouring countries in infrastructure⁶²⁰. This can also be said to be a response to China's increasing engagement and investments in South Asia, a region once considered to be India's backyard. As such, between 2014-18, India invested almost USD 1.4 billion in infrastructure in South Asia⁶²¹. In Bangladesh, Myanmar, Bhutan and Nepal, 86 percent of the total outlay went to infrastructure projects, while in Nepal alone, 73 percent of the total outlay was dedicated to infrastructure, with the Postal Highway, or the Hulaki Rajmarg, getting 39 percent of the total outlay.

In 2018, Nepal made it mandatory for all Small Development Project (SDP) projects by India to be routed through the MoF. Prior to this, local units could approach the Indian Embassy in Kathmandu directly to fund projects in their constituencies. The intended goal of the new rule was to increase scrutiny over such projects and reduce the Indian mission's influence inside Nepal⁶²². However, the antagonism towards such SDP projects – and Indian assistance in general – can be seen in the controversy over the Barha Gaun Mukti Chhetra Rural Municipality's letter to the central government to request the Indian mission to fund a Buddhist Shakyas college⁶²³. The Buddhist college, said to be built at a cost of NPR 700 million, turned into a political game with UML opposition leader Oli saying Prime Minister Prachanda had 'betrayed' China by allowing India into a sensitive area such as Mustang, explicitly linking Indian assistance to an erosion of Nepali sovereignty. This remains a constant story of Indian assistance inside Nepal, with several water-sharing treaties in the past being seen as encroaching upon Nepali sovereignty and water rights. One could also argue this is why India had been hesitant in developing hydropower projects in Nepal in the past. However, this scenario is now changing, as we will see.

The political relationship between the two countries plays a key role in India's bilateral assistance to Nepal. Officials from both sides have regularly commented on the issue, with the Indian side suggesting a lack of political investment from their Nepali counterparts towards project completion, while the latter believes Indian aid to be motivated by Indian interests rather than in Nepal's interest. Several KIs we spoke to said Indian assistance had overt political goals, but one KI formerly with the Finance Ministry said Indian interlocutors were the easiest to negotiate with among all of Nepal's bilateral and multilateral partners.

Currently, Indian assistance in infrastructure in Nepal is directed towards expanding the cross-border railway infrastructure, the Postal Highway project, cross-border oil pipelines, and integrated check posts at border points. Indian companies have also invested in the hydropower sector in Nepal, with the Satluj Jal Vidyut Nigam developing the 900 MW Arun III project, and NHPC Limited developing the 750 MW West Seti project. In April 2023, Nepali private sector power developers organised a ‘Power Summit’, in which India was the country partner and several Indian companies showed interest in furthering Nepal’s power exports to India and the South Asian neighbourhood. Several Indian contractors are associated with multiple hydropower projects across Nepal, while a few contractors are also involved in road projects. Here, we will present a brief summary of India’s infrastructure engagement across these sectors in Nepal, including both the Arun III and the West Seti projects.

Figure 5. Indian Infrastructure Assistance to Nepal, Project-wise (2014-15)



Source: Outcome Budget 2016/17, Ministry of External Affairs, New Delhi

Railway infrastructure development by India in Nepal

Currently, India is the only country that has assisted Nepal in railway development. The Janakpur-Jayanagar cross-border railway, the second of its kind after the now-defunct Amlekhganj-Raxaul railway line, was for a long time the only railway line in Nepal. A MoU was signed in 2010 agreeing to extend the Jayanagar line to Bardibas via Kurtha and Bijalpura for a total of 68 km, along with four other cross-border railway lines: Jogbani-Biratnagar, Kakarbhitta, Bhairahawa and Nepalgunj⁶²⁴. According to the Indian Embassy, the Jayanagar-Bardibas railway link will cost NPR 7,148 million, while the under-construction Jogbani-Biratnagar line will cost NPR 3,200 million⁶²⁵. The Jayanagar-Kurtha section of Jayanagar-Kurtha-Bijalpura-Bardibas railway line came into operation in April 2022. In February 2023, the Indian Minister for External Affairs S. Jaishankar said work on the Kurtha-Bijalpura section is complete and survey work is being conducted in the final segment⁶²⁶. The Nepal Railways Company (NRC) had signed an agreement with Indian SOE Konkan Railways Corporation Limited (KRCL) to run operations, but the contract was turning out to be an expensive proposition for Nepal. NRC officials said if they could run it using Nepali and Indian human resources, they could save NPR 300-400 million annually⁶²⁷. NRC had been handling only the groundwork and staff management. In January 2023, the contract with KRCL was extended but Nepal has asked it to reduce service charges. NRC had not received any support from the MoF, and was running into losses⁶²⁸. The railway line features prominently in bilateral dialogues, with a special emphasis to Ayodhya Express bringing pilgrims to the religious town of Janakpur in June 2022.

The 18-km-long Jogbani-Biratnagar line is near to completion, with Jaishankar saying work on the 7.74 km freight line between Bathnaha in Bihar and Nepal Customs Yard (which was also built by India as part of an agreement to build three station yards and two bridges) had been completed and the GoN was expected to take over this rail segment shortly⁶²⁹. The Indian Ministry of Railways has been requested to allot a budget towards the construction of a railway repair centre at Jogbani⁶³⁰. The Jogbani-Biratnagar railway project was delayed by land acquisition issues, with the process of acquiring the land from the border to Biratnagar alone taking eight years (2011-19)⁶³¹.

Although India has prioritized cross-border railway lines, it has also begun final location survey (FLS) work on the Raxaul-Kathmandu railway link. According to Jaishankar, INR 39.72 crores had been sanctioned for the FLS, with the contract awarded to KRCL⁶³². The project is being seen as India's counter-offensive against the proposed Tibet-Kathmandu railway link, and is said to reflect the geopolitical rivalry between Nepal's two neighbours

inside the country⁶³³. Although China began a detailed feasibility study on the Tibet-Kathmandu train line in January 2023, progress on the Raxaul-Kathmandu railway line has been “more rapid”. KRCL is expected to submit its FLS by May 2023. The Raxaul-Kathmandu railway line was agreed upon during then PM Oli’s April 2018 visit, with the former director general of Nepal Railway saying he could “sense their urgency” after China came forward with its train proposal⁶³⁴. The length of this railway line is estimated to be around 140 kms.

The estimated costs of the other proposed cross-border railway crossings are as follows:

- 1) 12.11 km Nepalgunj road-Nepalgunj rail link: NPR 2384 million
- 2) 15.3 km Nautanwa-Bhairahawa line: NPR 2816 million
- 3) 70 km New Jalpaiguri-Kakarbhitta line: NPR 5727 million⁶³⁵

Road infrastructure development by India in Nepal

The 1,792 km long Postal Highway, or Hulaki Rajmarg, runs across the southern plains of Nepal parallel to the East-West Highway to its north, with a 975-km long highway connecting East to West, and 817 km of feeder roads connecting all Terai districts⁶³⁶. The project was first discussed in 1991, and revived in the 2000s. A DPR was prepared in 2006, and the 2010 MoU identified 650 kms of roads – both the highway and feeder roads – to be built in Phase 1 of the project at an estimate of INR 700 crores⁶³⁷. The MoU envisaged Phase 1 to be completed by 2014, but land acquisition issues significantly delayed the project. There were also issues between the consultants and the Indian contractors who were working on the project which had been divided into six packages, and “most contractors abandoned the project in Nepal”⁶³⁸. Up to 2017, only 71 km of roads had been built.

A new MoU was signed in 2016 which replaced the consultant, and created a joint venture between Nepali and Indian contractors for smoother project execution. The new MoU also mandated that GoN had to acquire 90 percent of land before the project went up for tender⁶³⁹. Fourteen packages were now tendered out instead of the previous six. The estimated project cost according to the Indian Embassy is now NPR 11.2 billion⁶⁴⁰. Phase 1 of the project is now complete, said S. Jaishankar in February 2023, with 13 out of the 14 road packages already handed over to GoN⁶⁴¹. India is also building a six-lane bridge connecting Kakarbhitta to Panitanki over the Mechi river, which will act as the end of the Asian Highway number 2 in India. India fully funded the INR 158.65 crore project through an ADB loan⁶⁴².

In May 2022, the NEA decided to build a 400 kV transmission line running along the Postal Highway as an alternative to another 400 kV line being built along the East-West Highway. This transmission line is expected to play a vital role in cross-border electricity trade.

In addition, India is building four integrated check-posts along the India-Nepal border at critical trade points: 1) Raxaul-Birgunj 2) Sunauli-Bhairahawa 3) Jogbani-Biratnagar 4) Nepalgunj-Nepalgunj Road⁶⁴³. The Birgunj ICP came into operation in April 2018, while the Biratnagar ICP was operationalized in January 2020. The agreement for the four ICPs was done in 2005, and land acquisition issues have plagued this project as well. The Nepalgunj ICP is under construction, while the Bhairahawa ICP construction has begun after Nepali authorities finalized the land acquisition process and is expected to be completed in two years⁶⁴⁴. The Birgunj ICP was estimated to cost NPR 3.2 billion⁶⁴⁵. The ICPs are expected to boost trade between the two countries, with Nepal-India trade in 2019-20 standing at USD 7.9 billion⁶⁴⁶. However, analysts have noted almost all Indian ICPs including those on the Nepal border are operating at full capacity, and will require to be expanded as trade grows.

India's engagement in Nepal's energy sector

Intriguingly, India's engagement in Nepal's energy sector has been on the lower side vis-à-vis other countries for the most part of their bilateral history. The political fallout of the Gandak, Kosi and Mahakali water treaties can be ascribed as a reason why India had not engaged more widely with Nepal's energy sector, but in the 21st century, this has come to change, especially with an Indian SOE's acquisition of the 900 MW Arun III hydro project.

Arun III Hydro Project

A master plan Study on the Kosi River Water Resources Development conducted by JICA in 1985 had identified a list of promising energy projects in Nepal, with Arun III being one of them⁶⁴⁷. A Least Cost Generation Expansion Plan (LCGEP) was created in 1987 with the help of Canadian International Water and Energy Consultants, which included a thorough evaluation of projects up to the pre-feasibility level⁶⁴⁸. The LCGEP determined that the most cost-effective means of meeting Nepal's predicted power demand until 2005 would entail a blend of thermal power, load management, and a two-stage Arun III hydroelectric project. A 1990 update to the LCGEP reaffirmed that Arun III formed an integral component of the plan. The proposed project at the time was estimated to generate 402 MW⁶⁴⁹. To address macro-economic affordability concerns, the project was restructured in 1992 as a two-stage initiative, with each stage providing a capacity of 201 MW⁶⁵⁰.

As of 1994, the Arun III project was estimated to cost USD 1.08 billion, with approximately two-thirds of the funding coming from external sources in the form of grants and soft loans. Primary donors included the IDA, ADB, France, Germany, Japan, Finland, and Switzerland, with the majority of the assistance package taking the form of soft loans payable over a 30–40-year period with a service charge of less than one percent. The total foreign assistance package was calculated to have a subsidy element of approximately 70 percent, with the project expected to generate approximately NPR 5 billion revenue annually at that time. By this time, Nepal had already spent approximately USD 20 million on the designs for the project.

On 18 October 1994, Madhav Kumar Nepal, then General Secretary of UML, wrote to the President of the WB in which he expressed grave reservations about the project's proposal and design⁶⁵¹. The letter cast doubt on the ability of the caretaker government to take crucial decisions on the project. The final approval for the project was scheduled by the World Bank Board on 3 November 1994. However, subsequent to the letter, the World Bank began having doubts about GoN's commitment and ability to manage such a large-scale endeavour. On 1 August 1995, WB President James Wolfensohn cancelled the project, citing concerns about GoN's ability to implement necessary measures such as power tariff reforms and prioritizing the public expenditure required⁶⁵². The project also faced difficulties in mobilizing additional funding due to delays, resulting in a cost overrun of USD 30-40 million. The subsequent 16-hour power cuts in Nepal have often been attributed to the World Bank's withdrawal from the project⁶⁵³.

Following the World Bank's sudden departure from the project, the initiative was resurrected five years later by the private sector, with electricity generation capacity now doubled⁶⁵⁴. GoN gave an approval to Los Angeles-based EurOrient Investment Banking Group to lead construction efforts. EurOrient's managing director, Ron Nechemia, had already applied for licenses for three Arun River projects, including the 402 MW Arun III, the 335 MW Upper Arun, and a feasibility study for the 308 MW Lower Arun. Arun III was now imagined to be built by private investors and not funded through concessional loans or tied bilateral grants. However, EurOrient Investment Group were unable to secure a Power Purchase Agreement with India⁶⁵⁵. In addition, they also failed to return the performance guarantee amount of NPR 40.2 million that the Electricity Development Centre had asked for. The company then requested an extension to complete the necessary paperwork⁶⁵⁶.

Following the political transformation in 2006, Arun III underwent a shift in focus and was now repurposed as an export-oriented venture. GoN's strategy now was to enlist a private investor through a global tender process. Additional feasibility assessments raised

the project's installed capacity to 900 MW⁶⁵⁷. In 2012, Investment Board Nepal (IBN) signed a project development agreement (PDA) with Satluj Jal Vidyut Nigam (SJVN) Arun III Power Development Company (SAPDC) Pvt Ltd. SJVN Limited, a joint venture between the Indian central government and the state government of Himachal Pradesh, was selected to execute the project based on a proposal evaluation process. As per the PDA, the project was to be implemented under the BOOT model⁶⁵⁸. GoN would take ownership of the project after 30 years of commercial electricity generation, and would receive 21.9 percent (197.1 megawatts) of electricity without charge during this period. Additionally, SJVN agreed to repay GoN all expenses incurred during the feasibility study.

It took eight years from the signing of the PDA in 2012 to complete essential aspects such as technical and environmental surveys, financial closure, and project construction commencement. SAPDC obtained a consortium loan of NPR 101.35 billion from seven banks in Nepal and India in February 2020. Five Indian banks, including State Bank of India, Exim Bank of India, Canara Bank, Punjab National Bank, and Union Bank of India, agreed to lend NPR 86 billion, while two Nepali banks, Everest Bank and Nabil Bank, agreed to provide NPR 15.35 billion. SAPDC also committed on investing NPR 2.65 billion for the development of the project⁶⁵⁹. SAPDC will also build a 300 km long 400 kV transmission line to export the power at a cost of USD 156 million⁶⁶⁰.

In May 2018, Indian PM Narendra Modi and Nepal PM KP Sharma Oli laid the foundation stone. The project is scheduled to be completed in 2023, ahead of the scheduled commissioning in February 2025.

Located at a considerable distance from Nepal's border with China, the project is deemed to hold significant strategic value both for India and Nepal. This initiative represents the most substantial investment made by any country in Nepal. Given its location, constructing the project and delivering the necessary equipment pose considerable challenges. The project site has been the subject of several low intensity bomb attacks, with bombs going off at the site in 2018, 2019 and 2020. The attacks have been attributed to the Netra Bikram Chand 'Biplav'-led breakaway Maoist faction, which professes itself against FDI.

By September 2022, the project had seen 62 percent completion and is being built quicker than the deadline⁶⁶¹. A year previously, in July 2021, Nepal signed another agreement with SJVN to develop the 679 MW Lower Arun hydroelectric project. The USD 1.3 billion project will be the largest FDI in Nepal's history, and SJVN is expected to submit a DPR within two years of the agreement. This project will be built under the BOOT model as well, and will be a tailrace development of Arun III⁶⁶². In May 2022, Nepal and India

signed a further agreement to develop the 695 MW Arun IV project. NEA and SJVN will create a joint venture with the former having 49 percent stake and the latter 51 percent⁶⁶³. The total cost is estimated to be NPR 79.12 billion. However, the project has run into land acquisition issues sporadically, with the latest being a demand for better compensation for those losing their land to the transmission line⁶⁶⁴.

As of March 2023, Arun III project had seen 65 percent completion, but only 15 percent of the work with respect to transmission lines had been completed⁶⁶⁵. Land acquisition issues have been common in most infrastructure projects in Nepal irrespective of the developer. Indian developers such as SJVN and GMR however have objected to new forest land acquisition guidelines that requires developers to provide compensation to all affected areas⁶⁶⁶.

India is currently seen as the primary energy market for Nepal's surplus energy. If the India-China stand-off continues to sharpen in the future, India will block market access to Chinese enterprises and projects through Nepal. In such a scenario, one can argue the development of the Arun III project is a successful instance of Nepal hedging its bets between its two neighbours, at least in the energy sector. However, the success of this model – an Indian developer building a Nepali hydro project for the export market on a BOOT model, with Nepal receiving free electricity for a certain period before the transfer of ownership – also depends equally on the political relationship between the two countries, and the public perception of such projects.

900 MW Upper Karnali Hydroelectric Project

The Karnali River, a transboundary river that originates on the Tibetan Plateau near Lake Mansarovar and is a major tributary of the Ganges in India, has been the subject of proposed hydropower development since the mid-1980s. With donor support from organizations such as the WB and JICA, various feasibility studies for hydropower projects ranging from 240 MW to 4,180 MW have been conducted on the river⁶⁶⁷. Currently, a 900 MW hydropower project is in its early stages, being developed by GMR Upper Karnali Hydropower Ltd., a subsidiary company of GMR Ltd, an Indian private sector infrastructure developer. Of the 900 MW, 500 MW is expected to be sold to Bangladesh, Nepal would receive 108 MW for free, while GMR would sell the rest to India⁶⁶⁸. Nepal would also receive 27 percent equity in the project, which is being constructed on a BOOT model with GMR operating the project for 25 years⁶⁶⁹.

GMR was awarded the project in 2008⁶⁷⁰. After a thorough environmental assessment, GoN granted environmental clearance to the project in April 2013, followed by a PDA with the Ministry of Energy and the Investment Board of Nepal in September 2014⁶⁷¹.

India's Directorate General of Foreign Trade granted GMR a 30-year license for importing electricity from the project. As per the agreement, GMR was obliged to finalize the financial closure by September 2016⁶⁷². In April 2016, a consortium of lenders including IFC, ADB, JICA and European Investment Bank visited the project site and issued a letter of intent to invest USD1.1 billion in the project⁶⁷³.

However, the project encountered obstacles in its development, which caused it to come to a standstill for several years. Initially, market uncertainty surrounding the power generated by the project caused delays in securing financing. GMR had to request extensions thrice to conclude its financial closure, which hasn't been completed as of writing⁶⁷⁴. The project faced external challenges such as the 2015 earthquake and the post-2015 constitution protests in the Terai plains, which contributed to further delays. The project was also hindered by a delay in agreement with the Indian government for power purchase and transmission to Bangladesh, which was vital to the project as it was envisioned as an export-oriented project from the beginning.

In 2020, Bangladesh issued a LoI to GMR with respect to purchasing power from the project⁶⁷⁵. The letter stipulated that Bangladesh would purchase 500 megawatts of electricity annually at a rate of 7.71 cents per unit for 25 years, or NPR 511.69 billion. The power will be transmitted via a 400 kV transmission line connected to the Indian grid. GMR had long been negotiating the price with Bangladesh, and the price offered was around 2.5 cents less than what GMR had asked for⁶⁷⁶. Bangladesh had signed an MoU with NTPC Vidyut Vyapar Nigam Ltd (NVVN) in 2017 to import electricity from the project.

However, GMR was unable to secure the necessary funds and requested an extension, expressing their commitment to finalizing the financial closure and power sale agreement. During the 51st meeting of the IBN in June 2022, it was suggested that the deadline be extended by the Cabinet of Ministers of Nepal, provided that GMR completes its financial management within 24 months⁶⁷⁷. In November 2022, the Supreme Court intervened and suspended the government's decision to extend the deadline for GMR Energy to secure the necessary funds and complete the financial closure. This decision has left the future of the project uncertain; however, the government did not accept the court's interim order and filed a petition seeking to have it revoked⁶⁷⁸. GMR also filed a review petition and the case was referred to a constitutional bench, which rolled back the SC's earlier decision in May 2023, paving the way for GMR to achieve financial closure.

GMR has held the license for the project for almost twenty years without making significant progress. The project was initially scheduled to be completed in 2012, but the government

extended the deadline again in 2022. This situation highlights how some Indian companies have taken over major projects in Nepal but failed to make any meaningful progress for years. The fact that the project has drawn significant diplomatic and political attention is also confirmed by the fact that the issue of court order was raised by Indian foreign secretary V.M. Kwatra during his February 2023 visit to Nepal. The issue was also raised during the joint secretary level working group meeting in February 2023, with Indian officials concerned about investment climate in Nepal for Indian companies⁶⁷⁹.

750 MW West Seti Hydropower project

The story of the West Seti project reflects Nepal's own foreign policy swings between its two giant neighbours. Originally awarded to an Australian company, the project was handed over to a subsidiary of China Three Gorges through a cabinet decision that did not follow procurement rules, then to an Indian SOE, who currently holds the license.

The West Seti Dam is a proposed 750 MW storage-type project on the Seti River in the far-western region of Nepal. Studies on the potential project began in the 1980s. Oriented towards export to India, an agreement to develop the project was first signed in 1997 with Australia's Snowy Mountain Engineering Corporation (SMEC) through a special purpose vehicle called West Seti Hydropower Company Limited (WSHPL) under the BOOT model for 30 years. Nepal was to receive 10 percent of the power for free, and India would purchase the rest, with the Power Trading Corporation of India having signed an agreement with SMEC to this effect⁶⁸⁰. A consortium was proposed, in which SMEC would have 26 percent ownership, ADB 15 percent, CMEC 15 percent, Indian SOE Infrastructure Leasing and Financial Services Ltd (IL&FS) 15 percent, the WSHPL Special Purpose Vehicle (SPV) 14 percent, and the GoN 15 percent respectively⁶⁸¹. Plagued by the Maoist war, the project went nowhere. ADB pulled out of the project after protests against the project on the grounds of environmental impact and involuntary resettlement schemes⁶⁸². Meanwhile, CMEC had decided to invest NPR 15 billion in the project, the estimated cost of which at the time was around USD 1.12 billion⁶⁸³.

Negotiations on the project were to be carried out in Beijing. A three-party meeting between Energy Ministry officials, CMEC and SMEC was held for 13 hours in 2009 in Beijing leading to an MoU between CMEC president Jia Zhiqiang and WSHPL director Himalaya Pande. The MoU, which was signed during the official visit of then prime minister Madhav Kumar Nepal in December 2009, set up a terrible template for the future, a former secretary recalled. According to two KIs with knowledge of the agreement, the agreement stipulated that GoN would make a sovereign guarantee on financial matters. A sovereign guarantee is one where the recipient government takes responsibility of the loan

if the primary borrower fails to pay back the loan. This agreement was also signed at the residence of the Nepali Ambassador to China, which was uncharacteristic for such formal agreements.

When the Nepali team returned to Kathmandu, talks began on how to proceed ahead with the project. But Nepali officials and bureaucrats began to suspect the intentions behind the agreement. Officials at the Finance Ministry rejected the assurance of sovereign guarantee. After strong reservations from other stakeholders, GoN began to backtrack on the agreement, leading CMEC to withdraw from the project citing Nepal lacked an investment-friendly climate. SMEC also stopped sending funds for office operations in August 2010. In July 2011, GoN revoked SMEC's license for the project.

In May 2011, Chinese developer China Three Gorges Corporation Ltd (CTGC) showed interest in the project. The then Maoist government negotiated with CTGC under the BOOT model for 35 years and 75 percent ownership, with 25 percent ownership remaining with NEA. However, questions began to be asked about the contract being awarded hurriedly without a bidding process⁶⁸⁴. CTGC even threatened to pull out saying they were disappointed at the “unnecessary media-mongering” over the lack of transparency in the deal⁶⁸⁵. Government officials were said to have written to the company requesting it not to do so. In August 2012, CWE Investment Corporation — a subsidiary company of CTGC — and the Ministry of Energy signed a MoU.

KIs previously in the government and knowledgeable about the matter said the roles of former Finance Minister Janardan Sharma and the Nepali business conglomerate ICTC were key in attracting interest from CTGC in the project, with the latter's “major” involvement in the deal with CTGC. A former secretary and KI who had travelled to Beijing in 2012 ahead of finalizing the deal said they told Chinese officials that if ICTC representatives were present during the meeting, they would have to end talks.

With respect to funding, in 2011, a Nepali minister said China EXIM Bank was interested in providing a USD 1.6 billion loan at both commercial and concessional rates – the interest rate was reportedly “below five percent” – for the entire project⁶⁸⁶. However, this proposal did not see much headway. In 2014, NEA asked for a USD 400 million concessional loan from China to fund its 25 percent equity. This loan, too, was never finalized.

In 2015, CWE Investment Corporation (CWEIC) sent a USD 1.5 billion proposal to the Investment Board Nepal (IBN) – a government body created to approve high-value foreign investment projects and oversees hydro projects above 500 MW capacity – to develop the project. There were fears that CTGC was not serious on going ahead with the project since there had not been any developments since the signing of the MoU. The IBN

had the responsibility to ease both the investor's and the NEA's concerns regarding power rates and management of surplus energy during the monsoons. CTGC was also concerned about land acquisition and resettlement questions⁶⁸⁷. These concerns were also raised by the CTGC chief during his March 2015 Nepal visit. However, an Energy Ministry official was quoted as saying since the West Seti was a private sector project, the government could facilitate to an extent, but the primary responsibility was that of the developer⁶⁸⁸.

In April 2015, IBN approved CWEIC's proposal, but the Energy Ministry deferred from signing the joint venture agreement saying it did not have the resources to invest.⁶⁸⁹ CTGC assured NEA it would assist in securing the USD 400 million investment as soft loans from Chinese banks in March 2016⁶⁹⁰. A CTGC investment department delegation visited Nepal and the project site subsequently, but these talks were inconclusive. CTGC then proposed reducing the capacity of the project to 600 MW after a feasibility study, but the NEA turned down the proposal⁶⁹¹. Nonetheless, the two were ready to move ahead on the agreement in 2017, with China EXIM bank reportedly agreeing in principle to provide a soft loan to NEA⁶⁹². The agreement was to be signed between NEA and China Three Gorges International Corporation (CTGIC), a subsidiary of CTGC. CTGIC had reportedly agreed to bring its share down to 51 percent, with 10 percent shares offered to locals affected by the project, and 14 percent to Nepali investors. A newspaper reported the shares would be sold to ICTC.

With respect to securing the funds for NEA, CTGC asked NEA via the IBN whether it could assure a corporate guarantee from a second party or the NEA itself, but the NEA refused saying the project itself would be the collateral. The MoU stated that any loans would be under the non-recourse financing model, meaning only the collateral itself would be at risk and the lender would be paid from the profits of the project itself⁶⁹³. The NEA was now losing patience with the negotiations and the delay by the Chinese developer. Nonetheless, in November 2017, after the government hinted at cancelling the contract, CTGIC and NEA signed the agreement.

However, within three months, CTGC threatened to pull out unless NEA revised its power purchase rates. NEA was offering NPR 12.4 per unit during the dry season and NPR 7.1 during the wet season. NEA refused to revise the rates, so CTGC then asked IBN to guarantee a 17 percent return besides issuing a sovereign guarantee⁶⁹⁴. CTGC also asked IBN to be allowed to sell the electricity in convertible currency for a period of more than 10 years against the norm. The signs were increasingly pointing towards a cancellation of the contract. By August 2018, government officials began to suggest that while NEA and IBN were both becoming accommodative of CTGC's demands – except the sovereign guarantee and the assured return – CTGC “did not show any intent to

carry forward the project”⁶⁹⁵. IBN had agreed to even reduce the capacity as CTGC had originally suggested. Nonetheless, CTGC withdrew from the project that same month citing financial infeasibility.

At the time, there were suggestions that one of the reasons behind CTGC’s withdrawal was also India’s unwillingness to purchase power from the project developed by Chinese companies. The project was always oriented towards the idea that India would buy its power. India’s message to then PM Oli during his April 2018 state visit was that Delhi would not be buying any energy from Chinese-developed projects in Nepal⁶⁹⁶. India’s interest in the project was clear from its inception as a mega dam, with IL&FS one of the potential investors, and SMEC discussing power purchase agreements with Indian SOEs. “If we look at the history of West Seti, Indian interest was always primary,” a KI with a private research body said.

After the withdrawal of CTGC, GoN tried to interest other investors, but failed to make any headway. The project was revived once again in 2022 when Nepal decided to discuss the project with India along with the long-dormant Pancheshwar multipurpose project on the Mahakali River. India’s NHPC Ltd then submitted a proposal to develop the project in May 2022, following PM Modi’s Lumbini visit and India’s new push to create a subregional power grid. In August 2022, Nepal approved NHPC’s proposal to develop both the 750 MW West Seti as well as the connected 450 MW SR-6 joint storage project at an estimated cost of USD 2.4 billion⁶⁹⁷. NHPC now has to complete a DPR within two years⁶⁹⁸.

The West Seti episode is revealing of Nepal’s precarious neighbourhood policy at a time when both of its neighbours are competing with each other. Nepal has tried to balance the two countries by awarding other hydropower projects such as those on the Marsyangdi river to Chinese developers while negotiating big ticket projects like Upper Karnali, West Seti and Arun III and IV with Indian developers. While geography and the growing power demand in Indian markets has played a role in India’s economic leverage over Nepal in the sector, India’s new regional connectivity push has also played a critical role. However, the slow pace of progress of Indian companies – as seen in the Upper Karnali case – will affect the public perceptions, as one of the charges levied against Indian engagement in South Asia is that it takes far too long to complete projects. However, prospects of regional power trade between Nepal, India and Bangladesh have created new possibilities among power developers and among Nepali policymakers, as evidenced during the April 2023 Power Summit, where Nepali private sector power developers signed MoUs for the export of 2,200 MW of power to two Indian companies⁶⁹⁹.

Timeline of the developments in West-Seti

Date	Events
1987	A pre-feasibility study was carried out by the French company Sogreah, which suggested a 37 MW plant without the construction of a dam. The capacity was later revised to a 380 MW storage type by the same company ⁷⁰⁰ .
1994	A Memorandum of Understanding (MoU) was signed by the then-Electricity Development Center (EDC) of the Ministry of Water Resources (MOWR) and Snowy Mountains Engineering Corporation (SMEC) of Australia to permit SMEC to conduct project-related research. The government also granted SMEC a survey license ⁷⁰¹ .
April 1997	An autonomous Nepalese firm called SMEC West Seti Hydroelectric Corporation Limited was founded ⁷⁰² .
June 1997	The construction license was granted to Seti Hydroelectric Corporation Limited. The project was estimated to cost NPR 120 billion ⁷⁰³ .
2009	The China National Machinery and Equipment Import and Export Corporation (CMEC) initially agreed to invest NPR 15 billion in the West Seti Hydro project during then-prime minister of Nepal Madhav Kumar Nepal's visit to China, but later backed out due to perceived lack of investment-friendly climate and poor governance, with the Asian Development Bank showing no interest either ⁷⁰⁴ .
August 2010	SMEC, the company's primary promoter, stopped providing funds for office operations ⁷⁰⁵ .
July 27 2011	The West Seti Hydro license was terminated by the government ⁷⁰⁶ .
2012	Government led by Baburam Bhattarai handed the project to China Three Gorges International Corporation ⁷⁰⁷ .
16 November 2017	The formal agreement for setting up of a joint venture to build the 750 MW West Seti Hydropower Project was signed by the Nepal Electricity Authority and China Three Gorges International Corporation, a subsidiary of China Three Gorges Corporation ⁷⁰⁸ .
August 2018	China Three Gorges Corporation hinted at pulling out of the project saying it was financially unfeasible because of the steep resettlement and rehabilitation costs ⁷⁰⁹ .
29 May 2019	During the yearly budget speech, the project's construction using Nepal's own resources was announced by the then-finance minister, Yubraj Khatiwda. With the announcement, the Chinese company effectively canceled a USD 1.6 billion plan ⁷¹⁰ .
12 May 2022	NHPC submitted a formal proposal to IBN for the construction of the West Seti Hydropower Project ⁷¹¹ .
18 August 2022	Investment Board Nepal (IBN) and NHPC Limited signed a memorandum of understanding to develop the 750 MW West Seti and 40 MW SR-6 hydroelectric projects ⁷¹² .

Petroleum supply projects

In August 2015, India and Nepal signed an agreement to build a 41-km-long petroleum pipeline between Raxaul in India and Amlekhganj in Nepal⁷¹³. A month later, protests broke out against the constitution and India imposed an unofficial blockade on Nepal, resulting in a shortage of petroleum products inside Nepal and leading Nepal to sign a petroleum agreement with China. The blockade also resulted in hardening Nepal's stance towards India, and convinced Nepali policymakers to reduce Nepal's economic dependence on India.

However, four years later, in September 2019, India and Nepal jointly inaugurated South Asia's first cross-border oil pipeline, with India entirely funding the USD 45 million project as a grant⁷¹⁴. The pipeline, which is 69 km long and goes up to Barauni in India, has a capacity of 2 million metric tonnes and was completed 15 months ahead of schedule. The pipeline, more than any other infrastructure related project, can be said to encapsulate India's deep strategic interest in Nepal, as well as Delhi's capacity to absorb a diplomatic setback in the 2015 blockade and move ahead with projects that are in its interest. Although Nepal had signed a petroleum supply agreement with China in 2015, Nepal is yet to implement the agreement with India continuing to hold the monopoly over petroleum supply in Nepal. At the same time, it is also suggestive of China's limited capacity to replace India as Nepal's primary economic partner, since geography and rugged terrain have constrained trade and cooperation over land between the two countries, especially in such cross-border infrastructure mechanisms.

Further to the Amlekhganj-Barauni pipeline, in August 2020, Nepal and India began to discuss the possibility of constructing three new petroleum and gas pipelines, a liquified gas plant, and oil storage facilities inside Nepal. A natural gas pipeline from Gorakhpur to Bhairahawa and an oil pipeline from Siliguri to Jhapa are under consideration, with a survey of the latter being conducted in February 2020⁷¹⁵. In March 2023, Nepal forwarded two proposals for the construction of a 52 km pipeline from Siliguri to Jhapa and a 69-km extension of the Amlekhganj pipeline to Lothar in Chitwan⁷¹⁶. Earlier in February, the construction of a second pipeline along the Amlekhganj route was said to be in its final stage, with this pipeline running parallel to the first one and will supply petrol and kerosene⁷¹⁷.

Nepal's electricity trade with India

In the post-conflict years till 2016, Nepal had been suffering from, in some cases, 16-hour long power cuts, with the WB estimating the power crisis costing USD 11 billion or 7 percent of the GDP⁷¹⁸. However, subsequent to the 2015 constitution stabilizing national politics to an extent, Nepal's power sector began to see an upturn. The power cuts ended

in 2018, and in 2021, with the operationalization of the Upper Tamakoshi project, Nepal officially became a power surplus state – albeit with a few riders. In the ‘dry’ season during winters, Nepal continues to import electricity from India, with around 33 percent or 400 MW of imports in 2022-23 winter and spring according to the NEA managing director Kulman Ghising⁷¹⁹.

Several of Nepal’s under-construction power projects have been operationalized in recent years, with power generation capacity reaching 2,400 MW in February 2023⁷²⁰. Nepal is also allowed to export 452.6 MW of electricity to India from 10 hydropower projects, but the approvals have to be renewed annually. Although Nepal is seeking to end such restrictive trade elements, Nepal exported power worth NPR 10.38 billion in the five months till mid-November 2022, with power export already becoming one of Nepal’s top exports⁷²¹. India had allowed Nepal to sell electricity in its market in November 2021. Power export to India is expected to touch NPR 16 billion in FY 2022-23, and NPR 30 billion by 2023-24.

The most significant step towards realizing the value of Nepal’s long-vaunted power potential is the possibility of Nepal exporting surplus power to Bangladesh using the Indian transmission line of Baharampur-Bheramara⁷²². While both Nepal and Bangladesh have been raising the issue and seeking Indian agreement on the matter in diplomatic meetings, the official Indian response is awaited, although India is said to be positive towards such trade. If Nepal is able to export power to Bangladesh, it will be a boost both to regional connectivity under the BBIN framework, as well as create a regional power grid that will bring the three economies together in a region traditionally seen as one of the least economically integrated regions in the world.

In April 2022, Nepal and India released a joint vision statement on cooperation in the power sector, which paved the way for further cooperation⁷²³. However, Indian power trade rules – which also gives it leverage over regional connectivity – have been a barrier in a smoother transition towards such possibilities. Nepal has asked for a long-term power purchase agreement replacing the current day-to-day fluctuations in power prices in the day-ahead market⁷²⁴. Nepali developers are also worried at Indian power purchase rules with respect to projects with Chinese involvement, which, one can argue, is intended to discourage Nepal from allowing further Chinese participation in its power sector.

A joint secretary level meeting in February 2023 has been described as a milestone regarding access to Indian power markets for Nepali developers. India has agreed to review the existing annual renewal provision for Nepali developers, and will also review Nepal’s participation in the real-time power trading market. But equally important is the decision

to build more cross-border power transmission lines. The two countries agreed to increase the capacity of power transmission on the Dhalkebar-Muzaffarpur line to 800 MW from the current 600 MW⁷²⁵. The transmission line was built in 2016 with an Indian investment of USD 13.2 million, utilizing the LoC between the two countries⁷²⁶. The overall cost was USD 22 million. India has also agreed to build two new high-capacity cross-border transmission lines, with the two projects being developed under the investment modality of the under-construction 400 kV New Butwal-Gorakhpur cross-border transmission line. Eighteen km of this transmission line inside Nepal will be built under the USD 500 million Millennium Challenge Corporation grant by the US⁷²⁷. The joint secretary-level meeting also agreed to upgrade several low capacity cross-border transmission lines.

In a sign that Nepal may finally be able to export power to Bangladesh, India has agreed to grant its approval once Nepal submits the names of the projects which will export power to Bangladesh. Bangladesh will initially import around 50 MW of power, but is also keen on developing hydropower projects in Nepal in joint ventures⁷²⁸.

Although China and Nepal have listed a 400 kV transmission line from Rasuwagadhi to Kerung as part of the BRI, there have been few developments on the possibility of Nepal exporting power to China. Nepal first made the request for a cross-border transmission line in 2016. The feasibility study indicated the line would be around 70 km long and could carry 5000 MW. In February 2023, a meeting between NEA and State Grid Corporation of China officials ended on a positive note, with China seeking power imports to TAR during the winter season. However, the Chinese sought to reduce the load capacity of the transmission line to 220 kV since Nepal already has a transmission line of the same capacity near the border. Nepal, however, would prefer a 400kV line for cross-border trade⁷²⁹.

Japanese engagement in Nepal's infrastructure sector

In the 1970s, Japan emerged to become a critical bilateral partner in Nepal's infrastructure ambitions, with its technical expertise, concessional loans, and grant assistance that also involved debt relief. Japan's ODA assistance is marked by a few features that make it distinct from other donors, not just in Nepal but across the world. The 'request principle' is commonly said to underpin Japan's ODA assistance, in that 'Japanese ODA was offered based on requests from the recipient rather than proposals from the donor'⁷³⁰.

Japan has also historically prioritized bilateral aid, with nearly three-fourths of its overall ODA being provided as bilateral assistance⁷³¹. Its assistance was also influenced by the Fukuda Doctrine, a result of the Japanese prime minister's 1977 speech to South East Asian countries in which he said Japan would prioritise economic partnerships than security-

oriented ones. Japan was also the first non-socialist country to provide concessional assistance to China in April 1980 after it extended a 50 billion Yen loan to finance infrastructure projects⁷³². Thus, economic assistance became Japan's tool for expanding influence, and as such, it rose to become the world's largest donor country by 1989.

Japan's ODA assistance has featured both grants and concessional loans, with its share of grants being greater towards low-income countries like Nepal. 'Most of the projects eligible for grant financing are social and agricultural, with a relatively small cost component (for example, the construction of schools and hospitals). Loans, by contrast, are typically made for large infrastructural projects (the construction of railroads, highways, and hydroelectric power plants), which are expected to yield a reasonable rate of return'⁷³³. Japan is also notable in that three-fourths of its aid historically has been provided through bilateral mechanisms, and its preference for loans. In 2018, loans made up 60 percent of Japan's bilateral ODA. Japanese aid prioritises infrastructure, with 34 percent of the USD 4.5 billion disbursed in 2018 going to economic infrastructure sectors⁷³⁴.

In Nepal, Japanese assistance has been primarily directed towards infrastructure, particularly in transport and power sectors. Japanese technical and financial assistance was vital in constructing the Kulekhani hydropower project in the 1970s, as well as a cement plant in Udaypur in the 1980s. In the 1990s, Japan also funded the Kali Gandaki hydropower project. One of the outstanding features of Japanese assistance to Nepal – also noted by several KIs both in government and outside – is its debt relief measure, under which Japan had cancelled Nepal's outstanding debts worth 19.5 billion Yen between 1978 and 2002⁷³⁵. The debt cancellation measure has been a regular feature of Japan's bilateral assistance to Nepal, because of which former government officials we spoke to regularly remarked this feature as the highlight of Japanese assistance to Nepal.

In Nepal, Japan provided loans worth USD 29 million and grants worth USD 3 million in FY 2020-21⁷³⁶. Japan was one of the highest contributors to the energy and road sector in the fiscal year. This is in line with Japan's overseas assistance practices, which were reshaped in the 1990s after corruption scandals in the aftermath of the Asian financial crisis. JICA was then repurposed as an independent administrative institution and allowed to handle all three mechanisms of aid – technical assistance, grants and loans⁷³⁷. In 2015, it partnered with ADB to build infrastructure in Asia worth USD 110 billion in five years. In 2016, it added another USD 200 billion to the initiative. Between 1970, when JICA started working in Nepal, and 2015, Japan has provided technical assistance worth 71 billion Yen, concessional loans worth 79 billion Yen, and grants worth 198 billion Yen⁷³⁸. JICA chief representative Jun Sakuma also said around 52 percent of Kathmandu valley's water supply treatment facility has been supported by Japan.

Japanese aid – with its conditionalities that prioritise Japanese companies and technical expertise and create commercial opportunities for Japanese companies – can be said to have provided the foundation for aid practices of other countries such as China. “In 2010, 94 percent of Japanese aid was tied, against the DAC average of 16 percent. In 2018, Japan pledged to untie its aid and has reportedly reduced the share of its tied aid to 22.4 percent. But concurrently, the share of contracts won by Japanese firms from the untied aid has increased dramatically, from 12 percent in 2012 to 88 percent in 2017⁷³⁹. Japan also uses a request-based approach to its aid, meaning recipient countries usually approach it with a proposal for a project. However, as a KI said, this practice also means Japanese companies have at times identified projects in recipient countries such as Nepal which have then gone on to request funding for the project from Japan.

Table 9. Japanese Aid Disbursement During FY 2016/17-2020/21 (In USD)

S.N.	Fiscal Year	Agreed Amount	Disbursement
1.	2016/17	219,949,168	77,652,833
2.	2017/18	16,538,604	106,207,039
3.	2018/19	22,248,869	110,502,109
4.	2019/20	20,683,396	72,612,032
5.	2020/21	2,820,504	32,977,147

Source: Nepal Development Partner Profile Book, FY 2020/21

Japanese-funded road infrastructure in Nepal

In the past two decades, Japan has increasingly invested in road connectivity projects in Nepal, especially those connecting to Kathmandu. In the following section, we will discuss two case studies, namely the BP Highway, built under a grant by Japan, and the Nagdhunga tunnel, currently under construction.

BP Highway and Koteswor-Surya Binayak Road expansion

Originally imagined in 1958, the project went into limbo until 1996, 37 years later⁷⁴⁰. Several KIs said the highway project was revived after then prime minister Girija Prasad Koirala, brother of B.P. Koirala who originally thought of the project, requested Japan to build it in his memory. The 160 km highway, which connects Dhulikhel to Bardibas in the southern plains, was divided in four phases, with the first 37-km-long phase starting construction in 1996. The final section was completed in 2015, and handed over to the GoN in 2015⁷⁴¹. The project cost was estimated to be NPR 21.5 billion, with land acquisition and royalty costs borne by GoN, and the rest by Japan.

In 2017, a section of the highway collapsed, which was blamed to poor vehicle management on the highway and the effects of the 2015 earthquake. Public transport operators had

earlier in 2015 demanded that all types of vehicles to be allowed to ply on the highway, although the highway could only bear a load of 10 tonnes. The collapse was blamed on local administration and security forces not cracking down on vehicles heavier than 10 tonnes⁷⁴². The DoR was reportedly not keen on finding out the cause⁷⁴³. It took a year before the highway could resume for normal operations, and that too with Japanese technical assistance⁷⁴⁴. The issue of heavy vehicles once again came to the fore in 2018, with allegations that local stone crusher industries and heavy vehicle transporters had colluded with the local administration and flouted the Supreme Court's ban on heavy vehicles on the highway⁷⁴⁵.

In 2005, Nepal requested Japan to take up the expansion of a 9.1 km stretch of road between Koteswor-Surya Binayak inside the Kathmandu valley⁷⁴⁶. An agreement was signed with Nippon Koei in 2008, and was originally intended to be a six-lane carriageway, but was eventually built as a four-lane carriageway and handed over to Nepal in 2011⁷⁴⁷. In 2016, JICA carried out a preparatory survey at GoN's request and an additional one in 2018 for expanding a 16-km-long two-lane stretch that had become a bottleneck on the highway. JICA proposed two tunnels to be built at the Kathmandu valley's rim, and was estimated to cost NPR 22 billion with the tunnels, and NPR 16 billion without. JICA walked out of the project after differences arose with DoR over the costs⁷⁴⁸. In 2023, the DoR awarded the contract in two packages to Nepali contractors at a cost of NPR 10 billion.

Nagdhunga-Naubise tunnel

In February 2015, Nepal and Japan began to discuss the possibility of a 2.5-km-long tunnel between Nagdhunga and Naubise on the Prithvi Highway to ease the traffic congestion into Kathmandu valley⁷⁴⁹. Japan hadn't yet committed to Nepal's request to fund the project, but it had shown "great interest". A 'gentlemen's agreement' between GoN and JICA was that Nepali companies would be involved if the project was implemented via Japanese funding. The project was to be opened up for international bidding, and the winning contractor would have to form a joint venture with a Nepali contractor to help transfer tunnel technology and enhance local capacity. Japan's "keen interest" in the project was signified by a flurry of visits by Nepali ministers and officials to Japan. A JICA consultant had estimated NPR 15 billion as total cost, with the tunnel costing NPR 12.88 billion and land acquisition and other costs costing NPR 2 billion. By March 2015, JICA had "verbally agreed" towards a concessional loan at 1 percent interest for 40 years⁷⁵⁰.

The loan agreement was signed in December 2016, with Japan extending a loan of 16.63 billion Yen [NPR 15.28 billion], or 75 percent of the total project cost of NPR 20.41

billion⁷⁵¹. The interest rate was 0.01 percent, the lowest interest rate Nepal had received, for a period of 40 years. A grace period of 10 years was added⁷⁵². The completion deadline was expected to be December 2022. The project had two components: a 2.5 km long tunnel and a 2.6 km long approach road.

In March 2017, the DoR awarded Japanese company Nippon Koei the contract to prepare a DPR and supervise the construction of the tunnel at a contract price of NPR 990 million⁷⁵³. Nippon Koei would work with ITECO Nepal on the DPR. The DPR was readied in a year, and DoR had decided to issue a global tender for the project, for which six companies – five Chinese and one Japanese – were shortlisted⁷⁵⁴. However, the contract-awarding process saw delays due to a lengthy evaluation process. JICA had agreed to finalise both technical and financial proposals. The four Chinese contractors were disqualified, and JICA was criticized that the Japanese contractor Hazama Ando JV, which had been selected by the DoR, was given preferential treatment. Hazama Ando had also built the Koteswor-Surya Binayak Road as well as the BP Highway. However, JICA said it had no role to play in the selection of contractors⁷⁵⁵. JICA gave a go-ahead in July 2019, although land acquisition issues had already come to the fore⁷⁵⁶. Construction began in October 2019. Questions were raised over the necessity of the tunnel, especially because Nepal had begun planning an alternate fast-track road to connect Kathmandu to the southern plains⁷⁵⁷.

The project has been delayed, with reports suggesting it would not be completed before 2024 beyond the extended deadline of June 2023⁷⁵⁸. This was also because the tunnel work itself had begun only 14 months after the laying of the foundation stone in October 2019, as well as obstructions by locals due to land compensation issues. Reports said the project faced a deficit of NPR 250 million for land acquisition.

Comparative Analysis among the engagements of various countries in Nepal

The Nagdhunga tunnel project can be said to display all the characteristics of Japanese aid practices. The loan has been provided at an exceptionally low interest rate even by Japanese standards. The project can also be said to fulfil the Japanese aid conditionality of providing the contract works to Japanese companies – in this case, the same company that has also worked on other Japanese funded projects in Nepal. As a KI with a private research group said, JICA was primarily concerned about whether JICA-funded project contracts would go to Chinese contractors, and would protect the interests of Japanese companies as much as they could. “That’s their only concern, and in that sense, they are biased towards their companies, protecting the bids of their companies.”

Multiple KIs also raised the issue of Japanese-funded projects costing more than others. As the above KI said, “Traditionally, Japanese projects cost much more, also because such

procurement is already favoured towards Japanese companies. Japanese quality aside, the project is really expensive. Even if we are taking loans at 1 percent concessional rates, the question is do we need such expensive projects?” However, the KI acknowledged Japanese projects are the best in terms of quality. As for whether project costs would come down, they said unless non-Japanese companies apply for the bid, the costs wouldn’t reduce. Other KIs also emphasized that while host country requests drove Japanese assistance to fruition, some projects were often driven by a preparedness on part of the Japanese company itself. The Japanese, thus, often look at projects as their legacy.

In the case of BP Highway, however, it was Nepal’s insistence – and the personal interest of former prime minister Girija Prasad Koirala – that drove the project. The KI formerly with the Planning Commission said the Japanese didn’t usually take such big projects but they made an exception in this case. “Nepal simply told Japan we want a road that meets our specifications and you have the technical skills.”

However, it is commonly accepted wisdom within Kathmandu’s aid and finance policy circles that Japanese support should be welcomed, not least because of their technical expertise, but also because of their practice of debt relief. One KI said the interest Nepal pays on Japanese loans is brought back into the country by Japan and spent on projects here itself. Multiple KIs also confirmed that although Japanese aid has its conditionalities, it is greatly welcomed. Such a perception also has to do with Japan’s historical presence and assistance in the country, as well as Japan’s low engagement in Nepal’s domestic politics, with its presence primarily associated with critical foreign assistance. Such perceptions also hint at both donor practices as well as recipient country agency in the selection of projects. On the other hand, Indian and Chinese engagements in Nepal are both a function of the political relationship as well as the respective country’s priorities in the South Asian neighbourhood.

Perceptions and Politics: Indian and Chinese engagement in Nepali infrastructure

There is a longstanding perception among both Nepali policymakers and the general population that Indian engagement in Nepal is targeted on furthering its own interests rather than for Nepal’s benefit⁷⁵⁹. This perception is compounded by the close bilateral relationship the two countries share, which results in political differences erupting every now and then, most recently in 2020 with Nepal issuing a new political map claiming the contested areas of Kalapani and Limpiyadhura as its own. The resultant border dispute, the legacy of the 2015 blockade, and China’s expanding political influence in Nepal has affected bilateral relations to a large extent in the contemporary era, with several Nepali conservatives also blaming India for the fall of the Hindu monarchy in the country. Thus,

Indian engagement in Nepali infrastructure – whether through its grant mechanisms or via its developers – is often viewed with suspicion, and Indian policy measures such as not allowing power exports from projects developed or financed by China are seen as measures that go against the spirit of the bilateral relationship.

On the other hand, although India has increasingly focused on expanding its connectivity projects with Nepal after 2015, and also speeding up work to allay the image of Indian projects suffering from questionable delays, Delhi has also been clear in its approach on not providing market access to China via Nepal. This has to do both regarding the now-strained India-China relationship, as well as signalling to Nepal that while the latter may prefer Chinese investments and engagement over India's, Delhi will negate such engagements if they view India as a potential market.

There is also the fact that Nepal's Left politicians tend to politicize India-Nepal ties for partisan benefits, as seen in the recent outburst by UML leader Oli over the Buddhist college in Mustang in 2023. Nepal's Communist leaders have been particular about not being tagged as pro-Indian while in government. Similarly, when out of government, anti-Indian sentiment is whipped up by Nepali politicians whenever bilateral issues appear. Such mobilization of public sentiment towards determining Nepal's foreign policy choices has been detrimental to Nepal's relation with Delhi, especially since in private conversations, several KIs previously associated with the government have noted the ease and comfort in negotiating with Indian officials.

A KI formerly with a multilateral institution said that both China and India are explicit about the fact that their aid and engagement is a political and foreign policy tool. "But both countries do not have impressive record with infrastructure in Nepal." Another KI with a private research organization said Indian companies learnt the harsh lesson in Nepal much earlier that only government approval would not be enough for a project to succeed. "Unlike the Indians, the Chinese do not have the same level of footing inside Nepal... There are wide examples of projects failing because of failure in dealing with communities. The Chinese have a very different understanding of implementation. They don't understand that one has to deal with multiple levels in Nepal. But they are slowly learning." That both countries utilize their foreign assistance in Nepal to further their influence was agreed upon by another KI who was formerly with the Planning Commission. With the projects funded through the LoC provided by India's EXIM Bank, they said while conditionalities exist in such projects, there is international competitive bidding, and "India is okay with that." However, the KI said the same could not be said for China's practices in Nepal.

Our research also suggests that while negotiations and other processes related to Indian infrastructure engagement in Nepal are available in the public domain, those related to Chinese infrastructure engagement are not widely available in the public domain. The embassies of both countries play a role in furthering the business interests of their companies, but in the case of China, as we have seen, it has also been noted that Chinese companies usually zone in on projects that are politically manageable and can be awarded to them without following the usual norms. This, perhaps, is the key difference between the two countries' engagement in Nepal's infrastructure, and is also revealing of how their relationships with Nepal's political elite have evolved over time.

While China had engaged primarily with the monarchy prior to 2006, it needed to expand its relationship with other political parties subsequent to Nepal becoming a republic. India, on the other hand, has always engaged with Nepal's political parties – although one could argue the Nepali Congress shares the closest relationship with India among all of Nepal's political parties. India has also been deeply engaged with Nepal's political transformations, and in many instances, played a key role in the transformation itself.

However, the perception surrounding the two countries within Nepal – both among the elite and the public – are diametrically opposite. Compounded with this fact is the increasingly shaky India-China relationship, and Beijing's unease at India's partnership with the US in the Indo-Pacific and the Quad forums. While India must work harder to shake off the suspicions its activities in Nepal generates, it remains evident that Chinese engagement in Nepal will continue to grow. As a former Indian foreign secretary summarized, "The future of China-India-Nepal relations is likely to be determined by three factors: 1) whether China sees relations with Nepal as a zero-sum game vis-à-vis India, 2) whether Nepal recognizes the new situation and can adapt, and 3) whether India has the capacity to structurally recalibrate relations with Nepal"⁷⁶⁰.

The US, MCC, and Nepal: Missing the bus?

In the past few years, the US has become engaged in Nepal's infrastructure through the USD 500 million Millennium Challenge Corporation grant (MCC). Originally established in 2004, Nepal first approached the US regarding the MCC in 2012, and it was highly positive about the grant⁷⁶¹. Nepal signed the compact in 2017, but because the compact needed to be ratified by Parliament, the issue snowballed into a larger controversy that reflected not just Nepali concerns about American influence, but also the global US-China contest⁷⁶².

In Nepal, MCC funds were to be directed towards a 315 km long 400 kV transmission line, portions of which would eventually assist in power trade with India, substations, and

highway maintenance⁷⁶³. Nepal would additionally put in USD 130 million in what is the single-largest grant in the country's history⁷⁶⁴. Although the US has clarified otherwise, the inclusion of the MCC programme under the Indo-Pacific framework under the Donald J. Trump administration by the US led many in Nepal – particularly those from the Left – to believe it was part of a larger security-driven strategy to contain China⁷⁶⁵. In February 2019, Joe Felter, US Deputy Secretary of Defense for South and Southeast Asia, compared the MCC to the BRI and said Chinese investments in Nepal must serve Nepali interests and not Chinese⁷⁶⁶. Felter said, “Some activities associated with the BRI that we see to be very much in China's interest and not necessarily in the interest of the country where the activities are taking place... Look at Hambantota Port in Sri Lanka, among other projects we're already familiar with.” A day later, the Chinese ambassador said his comments were irresponsible⁷⁶⁷.

Even as Left politicians made it evident that they would not sign on any treaty that included security components⁷⁶⁸, the debate over the MCC made it in the public sphere, especially after the American withdrawal from Afghanistan in 2021. At that time, a new government made of a coalition of Nepali Congress, the Maoists and other groups was in power, and both the Prime Minister Sher Bahadur Deuba and Maoist leader Prachanda had written to the Compact saying the treaty would be ratified in Parliament within four-five months⁷⁶⁹. However, in public appearances, Prachanda and his party members continued to oppose the treaty, while UML leader Oli also did not lend support to the treaty when out of government. Meanwhile, public opposition grew, fuelled by what the US has called a ‘disinformation campaign’ by China – which rejected the allegations but called the compact a ‘Pandora's box’ after the US set a deadline of 28 February 2022 to ratify the treaty⁷⁷⁰. Those opposing the MCC included former Nepali ambassadors to China, and believed the MCC would undermine Nepali sovereignty and – among other things – bring in American troops into Nepal as in Afghanistan.

After the US said non-ratification of the treaty would lead to a review of bilateral ties, the ruling coalition went into overdrive and passed the treaty, albeit with an “interpretative declaration” that said the MCC was only a development grant that wasn't above the country's constitution and Nepal could terminate it if it went against the national interest⁷⁷¹.

Subsequent to the ratification of MCC, the familiar issue of land acquisition has come up in the project's implementation⁷⁷². The MCC is a five-year limited term grant, thus it is key for Nepal to resolve land acquisition issues as soon as possible before moving on to the construction of transmission lines.

The MCC controversy, beyond straining ties between Nepal and the US and putting Nepal in a tight spot between US and China, also displayed the nature of domestic politics in

Nepal. The opposition to the MCC was primarily fuelled by ultranationalist rhetoric from the Left parties, and saw extensive misinformation filtering to the ground⁷⁷³. However, opposition to the MCC had been growing, and one may argue that the US was hoodwinked by the verbal commitments given to them by Nepali Communist leaders. Nonetheless, Nepali politicians are known to take different positions on an issue of national interest when in government and in opposition respectively.

Opposition around the MCC was also based around traditional Communist critiques of the US, amplified by the US withdrawal from Afghanistan and China's Ministry of Foreign Affairs' statements that Beijing opposed such 'coercive diplomacy'⁷⁷⁴. Whether such opposition was rooted in the 'disinformation' campaign inside Nepal and funded by China as suggested by the US is not fully evident from public sources⁷⁷⁵, but what was clear was that the tendency of Nepali politics to rely on ultranationalism as an opposition tactic remained as persuasive as in the days of the monarchy.

The MCC also marks a shift in the American aid approach in Nepal. As noted earlier, USAID withdrew from large-scale infrastructure projects in Nepal due to an unwelcoming environment and poor performances. With the MCC, however, the US has marked a return to Nepal's infrastructure sector – albeit in small measure compared to other partners. The Compact has been posited as an alternative to the BRI, especially with respect to the MCC being a grant as compared to China's loan mechanisms. However, although BRI projects have not seen much movement, Chinese engagement in Nepali infrastructure has been extensive compared to the MCC. As a KI said, it was possible that an MCC contract could land with a Chinese developer as well.

Similarly, although the MCC grant is the single-largest grant in Nepal's history, other countries such as India and Japan have extensively engaged with Nepali infrastructure as well. Thus, the playing field in Nepal's infrastructure is currently seeing expansive engagement from multiple countries. Unless the MCC outperforms the other partners in Nepal's infrastructure sectors, and the US expands its physical infrastructure engagement inside the country, the MCC will be seen as just another development project in the long history of such projects in Nepal.

In a recent update, the government has pledged a budget of USD 67 million in 2023 to facilitate the implementation of transmission line projects under the MCC⁷⁷⁶. Alongside this, six Indian companies have submitted their bids for the construction of these transmission lines, which will be carried out in three distinct packages, and the bidders include the Association of Megha Engineering and Infrastructure Ltd and Power Mech Projects Ltd, Kalpataru Power Transmission Limited, KEC International Ltd, Transrail Lighting Ltd, Tata Projects Ltd, and Larsen and Toubro Ltd⁷⁷⁷.

CHAPTER V

Same But Different: Comparative Analysis of China in South Asia

Summary

China's financial assistance and investments in Nepal have been significantly lower in absolute numbers compared to other countries in South Asia, excluding India, Maldives, and Bhutan. For example, Pakistan, which enjoys a significant defence and military cooperation with China, has received at least USD 25 billion in Chinese investments since the establishment of the China-Pakistan Economic Corridor (CPEC) in 2015. Chinese investments in Sri Lanka's infrastructure between 2006 and 2019 amounted to USD 12.1 billion, while in Bangladesh, it totalled an estimated USD 9.75 billion between 2009 and 2019.

While there are similarities in the political landscape of South Asian countries, such as the prevalence of family and kin networks within the political system and corruption, they have different political systems that have evolved as a result of their respective histories. These differences contribute to variations in patterns of Chinese engagement in these countries. The primary difference lies in the volume of investment received, which is also influenced by the size of their respective economies.

China's engagement in South Asia is otherwise driven by several factors. First, its longstanding security relationship with Pakistan has resulted in a unique partnership between the two countries. Second, China aims to counter India's historical hegemony in the region and has strategically negotiated and has tried to minimize India's influence in South Asia. Additionally, China seeks to secure its maritime routes via Pakistan, Sri Lanka and the Maldives and establish overland resource supply chains through Pakistan, Bangladesh, and Myanmar. China sees South Asian markets as opportunities for its goods, services, and state-owned enterprises to expand their capacity.

China's economic power and longstanding political relationships are its primary asset for gaining influence in South Asia. The country has supported large-scale infrastructure projects in almost every country in the region. China's tools of influence have also diversified, engaging both state and non-state actors.

However, it is important to note that China's influence in South Asian countries can often be overstated. Local political actors and agency play a crucial role in determining the extent of China's influence, as in Nepal. Political agency in these countries is influenced not only by local demands but also by factors such as balancing relations with India and the push factor from local agents and companies driving projects forward.

The relationship between Sri Lanka and China, particularly regarding the development of the Hambantota port, has sparked ongoing debates and serves as evidence for critics of Chinese infrastructure aid in developing countries. However, China's engagement with Sri Lanka predates the Hambantota port and involves various political actors beyond the Rajapaksa regime. The 2022 Sri Lankan economic crisis resulted in the Chinese debt trap narrative; a close study reveals fundamental weaknesses in the Sri Lankan economy, compounded by the Covid-19 pandemic, and the high cost of borrowing through international sovereign bonds may be the primary reason behind Sri Lanka's external debt default. Despite this, the narrative of "debt-trap diplomacy" continues to be pushed by those opposed to China's expanding global influence.

The China-Pakistan relationship similarly dates back to the Cold War era. Both countries recognized the need to contain India and signed agreements that solidified their bilateral relationship. The China-Pakistan Economic Corridor (CPEC) is a significant infrastructure connectivity project, with an estimated value of USD 60 billion. Despite controversies surrounding CPEC, including instances of corruption and disagreements over projects like the Diamer-Bhasa dam, China has extensively contributed to Pakistan's economy and military forces. Pakistan also owes a large chunk of its external debt to China, and these issues were further compounded during the 2022-23 Pakistan economic crisis.

China's relationship with Bangladesh has also expanded significantly in the 21st century. China has invested heavily in infrastructure projects in Bangladesh, and Chinese investment accounts for a significant portion of Bangladesh's total external debt. While the two countries share a common interest in trade, Bangladesh has taken a cautious approach in its dealings with China, prioritizing its relations with India and ensuring that Chinese investments align with its national interests.

Nepal has received significantly less financial assistance and investments from China in terms of absolute numbers compared to other countries in South Asia, excluding India, Maldives and Bhutan. For instance, Pakistan, which enjoys a significant defence and military cooperation with China, has received at least USD 25 billion in Chinese investments since the establishment of the landmark CPEC in 2015⁷⁷⁸. China and/or its companies also made up a third of all FDI received by Pakistan in 2018-19, with Pakistan's debt owed to China by June 2022 nearly USD 6.7 billion⁷⁷⁹. Sri Lanka received USD 12.1 billion in Chinese investments in its infrastructure in the period between 2006 and 2019, or 14 percent of Sri Lanka's 2018 GDP⁷⁸⁰. In Bangladesh, Chinese investments in infrastructure totalled an estimated USD 9.75 billion in the period between 2009-2019⁷⁸¹.

In contrast, in the period between 2000-2017, AidData estimated that Nepal had received USD 4.5 billion in Chinese investments, grant assistance, and loan packages. However, this data set included pledges such as the USD 1.6 billion by China EXIM Bank as a loan commitment towards the West Seti hydropower project, which now has been handed over to India's NHPC Ltd⁷⁸². The actual figure of Chinese investments in Nepal during this period, thus, will be lower than this estimate. A more closer estimate at the Department of Industry Statistics 2021-22, records the value of all FDI from China into Nepal at USD 1.6 billion. Nonetheless, all four countries are members of the BRI, and have varied levels of engagement with China.

Both similarities and differences exist in the nature of Chinese engagement in our case countries of Sri Lanka, Pakistan and Bangladesh, and Nepal. The primary difference is the volume of investment these countries have received vis-à-vis Nepal, which also has to do with the size of their respective economies. Because South Asian political institutions are, to a large extent, similar in the operational mechanisms – such as prevalence of family and kin networks within the political system, and prevalence of corruption as noted by the global corruption index – it is tempting to qualify the respective countries' political systems as being similar. However, because the countries have different political systems that have evolved as a result of their histories – for instance, in Bangladesh's case, it emerged as an independent country out of the partitioned Pakistan state in 1971 – only broad similarities can be qualified.

From the Chinese perspective, its engagement in South Asia is predicated on several factors. The first is its longstanding security relationship with Pakistan, dating back to the 1960s, which has resulted in a unique relationship between the two countries. The second factor determining Chinese engagement in South Asia is India's historical hegemony in the region and the border dispute between the two countries, and how China has negotiated, and at times blunted, India's influence in South Asia. This has been intensified in the 21st

century as China has become more ambitious and cognizant of its global power status. This also includes China attempting to secure its maritime routes via Sri Lanka and the Maldives, and securing its overland resource supply chains via Pakistan in the west and Bangladesh and Myanmar in the further east. The third factor is China's access to South Asian markets for both its goods and services, as well as opportunities for its SOEs and other companies to expand capacity.

China's primary asset allowing it to gain influence in South Asia is its economic power, with China helping to construct big-ticket infrastructure projects in almost every country in the region. China's tools of influence have also diversified, engaging both state and non-state actors in the region. However, the narrative of "debt trap" – the belief that China consciously engages in entrapping countries with its loans and gaining control of their assets – has been shown by multiple studies⁷⁸³ to not be true. Nonetheless, the narrative continues to persist, with opposition politicians invoking it whenever they need to attack the government's China policies. Most importantly, the terms of Chinese engagement in each of the countries is often determined by local actors, displaying significant agency while choosing or rejecting deals with China and/or its companies⁷⁸⁴.

China's influence in these South Asian countries can thus often be overstated, but as we have seen in Nepal, local political actors and agency is often the most important factor in determining how far China's influence extends in these countries. In the case of Nepal – and elsewhere in South Asia – local political agency is vital in the progress of a project. However, such political agency may often be influenced by factors other than local demands or issues, such as an attempt to balance relations with India, and the push factor driving projects ahead that comes from local agents and companies.

China's engagements in Sri Lanka

In the recent years, Sri Lanka's relationship with China, especially surrounding the development of Hambantota port, has become a source of relentless debate and has been served as evidence by those arguing against Chinese infrastructure aid in developing countries. But Sri Lanka's relationship with China predates both the Hambantota port as well as the Rajapaksa regime. Sri Lanka was among the first countries in the world to establish diplomatic ties with the PRC, and in April 1952, the two countries entered into a rubber-rice swap deal, under which Sri Lanka would export rubber in exchange for rice⁷⁸⁵.

In the 21st century, after Mahinda Rajapaksa was elected as president, he decided to escalate the three-decade-long civil war with the Liberation Tigers of Tamil Eelam (LTTE). With increasing human rights concerns, India and the US refused to sell the weapons to Sri Lanka in its attempt to end the war through military means. Sri Lanka then turned

to China, which led to a USD 37.6 million deal for the supply of weapons⁷⁸⁶. Since then, security cooperation between the two countries has only grown, with Sri Lanka finding a reliable partner and for China a strategic maritime asset in the Indian Ocean Region. Although India has its own security relationship with Sri Lanka, Delhi has become greatly uncomfortable at instances such as the August 2022 docking of a Chinese ‘scientific research’ ship – which India called a surveillance ship – at Hambantota port⁷⁸⁷.

The Hambantota port is located on the southern tip of Sri Lanka. It is also Mahinda Rajapaksa’s home constituency, which he has represented since 1970. Along with the Colombo Port City project – the largest FDI in Sri Lanka valued at USD 1.4 billion and built by China Harbour Engineering Company (CHEC), which also owns it⁷⁸⁸ – the Hambantota Port has invited the largest scrutiny in Chinese investments in the island-nation.

A 2006 feasibility study identified Hambantota as a possible site for non-containerized traffic to divert away from Colombo, which is the busiest port in South Asia⁷⁸⁹. The project found no backers, however, China Harbour Group, which was involved in the reconstruction of fisheries as part of the post-2004 tsunami reconstruction efforts, showed interest in the project. In 2007, at the invitation of Sri Lankan government, China began to aid the construction of Hambantota Port. In October 2007, China EXIM Bank agreed to provide a non-concessional loan of USD 307 million at an average interest rate of 6 percent for Phase 1 of the port project. That same month, Sri Lanka raised USD 500 million in five-year international sovereign bonds (ISB) at 8.25 percent. “Both borrowings set the trend for Sri Lanka’s debt build up over the next 15 years, driven by export credit and commercial borrowing, culminating in the April 2022 sovereign debt default”⁷⁹⁰.

The first phase of the port was declared open by November 2010, after Mahinda Rajapaksa secured a landslide victory for a second consecutive term as President. Although a feasibility study recommended waiting for Phase 1 to generate revenue before expanding the port, by December 2010, the second phase of the EPC contract was negotiated with China EXIM Bank on more concessional terms than the previous loan. In September 2012, Sri Lanka negotiated three different loans with the EXIM Bank valued at USD 807 million at 2 percent interest, although the third loan of USD 51 million was cancelled in 2019 and not disbursed. In total, China EXIM Bank’s total loan commitment to the Hambantota port was USD 1.326 billion, with another USD 147 million loan extended in 2013⁷⁹¹.

However, reports began to emerge by 2015 about port funds being used to fund the election campaigns of the Rajapaksa network. The *New York Times* reported at least USD 7.6 million being dispensed from China Harbor’s account at Standard Chartered

to the Rajapaksa's campaign during 2015 elections⁷⁹². The news played an important role in Rajapaksa's 2015 election defeat to Maithripala Sirisena. In 2018, another Chinese company – Colombo International Container Terminals Ltd, a joint venture between Sri Lanka Ports Authority (SLPA) and China Merchants Ports Holdings Co. Ltd (CM Ports) – admitted that it paid nearly 20 million Sri Lankan rupees to Basil Rajapaksa's family, the brother and economic development minister for Mahinda Rajapaksa⁷⁹³. The money was paid to Pushpa Rajapaksa Foundation, run by Basil Rajapaksa's wife Pushpa Rajapaksa, as a "part of its corporate social responsibility" intended to build houses for the poor⁷⁹⁴.

However, China has also engaged with other political actors in Sri Lanka beyond the Rajapaksas. In 2016, China welcomed then Prime Minister Ranil Wickremesinghe which led to signing of number of deals including grant of 500 million RMB "as a gesture of friendship and assured that China will continue to extend its support to Sri Lanka's investment zones and industrialization projects"⁷⁹⁵. Similarly, in 2015, Maithripala Sirisena's government approved Rajapaksa's China-funded projects – such as the Hambantota Oil Tank complex, the Sooriyawewa Cricket Stadium, and the Mattala Rajapaksa International Airport in Hambantota – that it had criticized and initially paused, suggesting China's deep engagement and networks within the ruling political elite in Sri Lanka⁷⁹⁶.

With the port, however, alarming signs had begun to emerge by 2014, when the Sri Lankan Treasury Secretary wrote to EXIM Bank asking for a restructuring of the loans in order to facilitate a Supply, Operate, Transfer (SOT) agreement with CM Ports and CHEC to expand the port. The proposed JV between the two Chinese companies did not materialize due to opposition against it in the 2015 elections. However, "[f]rom the beginning of operations [in 2010], the port was incurring losses due to low revenue which was insufficient to cover the repayments due"⁷⁹⁷.

Sri Lanka also began facing problems on Balance of Payment (BoP)s around this time, with exports stagnating and increasing debt servicing costs. Leasing out Hambantota was identified as one of the non-debt creating solutions. Debt issues had already forced Sri Lanka to go into an IMF programme by June 2016, and the government began to seek foreign investors in the Hambantota port to bridge the foreign exchange deficit. In 2017, Sri Lanka signed an agreement with CM Port to form the Hambantota International Port Group (HIPG), in which SLPA would hold 15 percent stake while CM Port would shell out USD 974 million in three tranches for the 85 percent stake in the port. The port was leased out to HIPG for 99 years⁷⁹⁸. This led to establishment of the narrative "debt-trap diplomacy" whenever explaining nature of Chinese investment overseas. However, as the China Africa Research Institute paper has highlighted, "Leasing the port not only increased foreign currency inflows, but also prevented SLPA from incurring further losses"

and it was not a debt-to-equity swap⁷⁹⁹. Nonetheless, the debt-trap narrative continues to be pushed forward by those opposing China's expanding global influence.

The roots of the ongoing economic crisis in Sri Lanka go far deeper than China's loans to the island-nation, although debts to China constituted around 20 percent of its public external debt at the end of 2022, with Sri Lanka owing China USD 7.3 billion⁸⁰⁰. "Contrary to popular belief...it was not Chinese debt alone that entrapped Sri Lanka in debt"⁸⁰¹. As several studies have shown, it was Sri Lanka's exposure to ISB, which had risen to 36 percent of its outstanding external debt by May 2022, and which had been borrowed from international capital markets at higher rates of borrowing, that proved to be the undoing⁸⁰². By the end of 2021, Sri Lanka had borrowed over USD13 billion in ISBs, which was 35 percent of the total government foreign debt⁸⁰³. In 2021 alone, Sri Lanka had to repay USD1 billion in principle and USD 934 million in interest on ISBs, which was twice the share of Chinese debt.

Table 10. Sri Lanka's external debt composition

Creditor	2000	2006	2011	2016	2017	2018	2019	2020	2021	May 2022
WB	24%	22%	13%	10%	10%	9%	9%	9%	10%	10%
ADB	21%	25%	16%	13%	13%	13%	12%	13%	15%	15%
Japan	32%	28%	22%	11%	10%	10%	9%	10%	9%	8%
India	0.2%	1%	2%	3%	3%	3%	2%	2%	2%	4%
China	0.4%	1%	9%	16%	15%	17%	17%	18%	20%	19%
Other Bilateral	19%	14%	7%	4%	4%	4%	4%	4%	3%	3%
ISBs	-	-	14%	28%	29%	35%	40%	38%	36%	36%
Foreign Held Domestic Bonds	-	-	11%	6%	6%	3%	2%	0.2%	0.1%	0.1%
Others	4%	8%	6%	8%	10%	7%	6%	5%	4%	4%

Source: SAIS-CARI, 2022

Nonetheless, Sri Lanka was facing a debt crisis. According to the 2021 IMF report, Sri Lanka's public debt-to-GDP ratio rose from 91 percent to 119 percent between 2018 to 2021⁸⁰⁴. By March 2022, its external debt servicing per year had increased from USD 2 billion to USD 6 billion, whilst its foreign currency reserves depleted from USD 7.6 billion at end of 2019 to USD 3.1 billion at end of 2021⁸⁰⁵.

It is important to understand China's subsequent role in managing its loans to the island nation. China's willingness to loan out huge sums without factoring in due diligence and rates of return while becoming the world's largest sovereign creditor in ODA shows that while countries could rely on China to provide quick capital without too many questions asked, "this very quality is now proven to have serious implications for international debt management"⁸⁰⁶. China has also shown it is not keen on debt restructuring and solutions, both from the Sri Lankan experience as well as its experience with the Republic of Congo in April 2019, where, "[a]fter the debt restructuring deal was struck in April 2019, the net present value of total repayments from Congo-Brazzaville to China EXIM bank increased from \$1.3 billion (before restructuring) to \$1.6 billion (after restructuring)"⁸⁰⁷. In March 2023, China EXIM Bank said it was willing to put a two-year moratorium on debt repayments as Sri Lanka negotiated a USD 2.9 billion IMF loan⁸⁰⁸. Sri Lankan officials, however, were said to have expected China to do more. The other major Chinese lender to Sri Lanka, China Development Bank, however, has yet to offer a similar package.

China's engagements in Pakistan

The China-Pakistan relationship also traces back to the days of the Cold War, despite Pakistan joining the US-backed Southeast Asia Treaty Organization (SEATO) and Central Treaty Organization (CENTO) military treaty in the 1960s. Pakistan was the first Muslim country to recognize the PRC in 1950. Both countries saw the need to contain India and signed an agreement in 1963 under which Pakistan recognized China's claims to the disputed region of Aksai Chin, an agreement India did not recognize. The bilateral relationship has been termed an "all-weather" relationship, and China has extensively contributed to shoring up both Pakistan's economy as well as its military forces.

The China–Pakistan Economic Corridor (CPEC) is a massive USD 60 billion infrastructure connectivity project that connects China's northwest region to the western province of Balochistan in Pakistan, and stands out as one of the most significant projects under the BRI across the world. Under CPEC, the Gwadar port is not only one of the four major priority areas of the overall CPEC corridor, but also a major project under BRI. "The World Bank estimates that, from 2014 to 2019, CPEC projects with an outlay of USD 32 billion were constructed or became operational, and feasibility studies on more USD 14 billion projects were completed"⁸⁰⁹.

The first proposal to develop Gwadar port was put forth by then Pakistani President General Pervez Musharraf in 2000. However, China was sceptical of the project for a long time as Gwadar was located in remote area, disconnected from major transport routes connecting China, and was the site of a strong and long-standing separatist movement in

Balochistan⁸¹⁰. On February 18, 2013 the leasing rights for the Gwadar port were formally transferred to China Overseas Port Holding Company which is registered in Hongkong⁸¹¹.

CPEC was subsequently established in 2015 and remained a signature project under the BRI. However, controversies surrounding CPEC started from its inception. Former Prime Minister Imran Khan's Pakistan Tehreek-e-Insaaf (PTI) party, which had opposed the CPEC during its launch, criticized then Prime Minister Musharraf for prioritizing project in his home constituencies and neglecting other parts of the country⁸¹².

In 2017, China decided to halt three projects under the CPEC citing instances of corruption which "left the Chinese officials disturbed"⁸¹³. This was followed by a series of controversies on the Diamer-Bhasa dam, initially considered a CPEC project. In November 2017, Pakistan withdrew from the USD 14 billion dam project after it claimed Beijing placed strict conditions, including on the ownership of the project, which were deemed "unacceptable" for Pakistan⁸¹⁴. Furthermore, the dam is being built on Indus River inside Pakistan-administered Kashmir, a disputed territory. Since the 1980s, Pakistan had sought assistance from the World Bank, ADB and other institutions for the project, but all of them refused as it was located in disputed territory⁸¹⁵, thus turning to China for help.

In 2020, a consortium of Chinese SOE China Power and Pakistan army's commercial wing Frontier Works Organization (FWO) began working on the project on a 70-to-30 ratio⁸¹⁶. No sooner after then PM Imran Khan's inauguration of the construction process in 2022, the locals began protesting citing the government did not pay any compensation for land that was forcefully acquired for the dam site⁸¹⁷.

Not only CPEC, but non-CPEC projects like the Dasu hydropower project have also faced numerous controversies under the PTI government leadership. In 2018, after winning the election, Prime Minister Imran Khan sent a delegation to China to learn about anti-corruption measures and how to eradicate corruption⁸¹⁸. In 2019, his government awarded the contract for the USD 2.21 billion Dasu dam project to the China Gezhouba Group and Descon, a company founded by Abdul Razak Dawood, then Prime Minister Imran Khan's advisor on commerce and industry⁸¹⁹.

In 2019, Transparency International of Pakistan wrote to Water and Power Development Authority (WAPDA) asking to examine the credibility of China Gezhouba Group Company due to its past irregularities with the World Bank, and in Nepal and other

contracts. In 2015, the World Bank had announced the debarment of China Gezhouba Group for misconduct⁸²⁰, around the same time Gezhouba was active in Nepal's Budhi Gandaki hydropower project.

In 2021, a parliamentary panel held in Islamabad said that China Gezhouba group and Descon were paid Pakistani Rs. 4.5 billion in advance for the project, prior to acquisition of land⁸²¹. Costs also escalated rampantly as the consultants responsible for the detailed engineering design of the project couldn't complete it within the stipulated time and had included flawed calculations⁸²². The progress of the project was hampered badly as on July 14, 2021, Dasu project's bus carrying Chinese and Pakistani personnel was bombed with several casualties from both nations⁸²³. This incident came just a month after Pakistani Prime Minister Imran Khan visited the dam project and highlighted the level of dissatisfaction and security concerns around the project. A key meeting of the CPEC was postponed after the attack and the Chinese side demanded a compensation of USD 37 million⁸²⁴. According to *Express Tribune*, despite no legal or contractual obligation on Pakistani government, they worked out the compensation amount and resumed work subsequently.

Scholars have commented on how the CPEC's route was affected by Pakistani domestic politics, with the choice to prioritise projects in Sindh and Punjab emanating from then Prime Minister Nawaz Sharif's electoral prospects. Similarly, the Gwadar port was a priority for both countries, but the rhetoric surrounding the CPEC has "often failed to match reality"⁸²⁵. And despite the perceived closeness between the two countries, Chinese companies have often complained about a lack of suitable business environment within Pakistan. "The CPEC has been hyped to the Pakistani people as a way to ensure local development, job creation, and the inclusion of all provinces. The reality is that the government has centralized power, and there is little evidence to date of new skilled jobs being created"⁸²⁶.

China has also invested heavily in Pakistan's energy sector, which has long suffered from a power crisis that have resulted in a loss of 7 percent of GDP per annum⁸²⁷. Under the CPEC, at least USD 18.9 billion have been invested into energy projects. With the Pakistan economy facing a debt crisis in 2023, focus has once again shifted on Pakistan's debt to China. At the end of 2022, Pakistan's external debt stood at USD 126.3 billion⁸²⁸. Debt servicing alone is estimated to cost its economy USD 26.4 billion in 2023. External debt has risen sharply from USD 60 billion in 2013, with the highest share of debts owed to multilateral institutions such as the World Bank and the ADB⁸²⁹.

China's lending practices have also been blamed for Pakistan's debt crisis. Around 30 percent of Pakistan's external debt is currently owed to China and/or its institutions, with around USD 27 billion owed to China in April 2021⁸³⁰. CPEC-related projects are said to contribute up to 6.6 percent of the total Pakistan's debt to China⁸³¹.

However, the economic crisis in Pakistan may solely not be attributed to its outstanding external debt. The 2022 floods devastated a third of the country, with agricultural production severely hit, and damages of an estimated USD 40 billion. The Pakistan rupee also slid by nearly 30 percent vis-à-vis the USD in 2022, leading to a further contraction in foreign exchange reserves⁸³². A longstanding neglect of the agricultural sector compounded with the damage by the floods has resulted in structural governance issues in the economy⁸³³. Further, the massive expenditure on CPEC projects that have not generated adequate revenue has also been blamed as a reason behind the crisis⁸³⁴.

Pakistan has been negotiating to unlock a USD 1.1 billion disbursement from the IMF, part of a USD 7 billion bailout Pakistan had negotiated with the institution in 2019, their fifth deal in the past two decades⁸³⁵. In response to the IMF's demands, Pakistan has hiked fuel prices, and opened up its currency to market-based exchange rates. In October 2022, Pakistan asked China to rollover a USD 6.3 billion loan package that was maturing in 2023. Saudi Arabia had also agreed to rollover USD 3 billion of debt that was maturing in December 2022⁸³⁶. Pakistan requires USD 20 billion in 2023-24 to service the outstanding debts⁸³⁷. However, in February 2023, China Development Bank agreed to loan Pakistan another USD 700 million⁸³⁸.

Chinese engagements in Bangladesh

The China-Bangladesh relationship had a difficult start – with China siding by its ally Pakistan during the 1971 war for Bangladeshi independence, although without providing material support to Pakistan. In the 21st century, the two countries have massively expanded their relationship. In defence, China supplies more than 70 percent of Bangladesh's arms, with China now helping Bangladesh build a submarine base as well⁸³⁹. China has invested heavily in Bangladesh, with investments totalling USD 1.159 billion in 2019 alone. The largest number of infrastructure projects developed with the help of Chinese aid in South Asia are in Bangladesh⁸⁴⁰. During Xi Jinping's 2016 visit, China and Bangladesh signed 27 agreements under which China would lend USD 24 billion to Bangladesh. As of 2022, Bangladesh owes about USD 4.7 billion, or almost 7 percent of its total external debt to Beijing⁸⁴¹, while its total external debt is at USD 72 billion. It owes USD 9 billion or 15 percent to Japan, its largest bilateral creditor⁸⁴². Between 2009 and 2019, China had

invested an estimated USD 9.75 billion in transportation projects in Bangladesh⁸⁴³.

Chinese investment in Bangladesh includes big-ticket infrastructure projects such as the construction of eight Bangladesh-China Friendship bridges, a sewage treatment plant, under river tunnel, economic zones, expansion of Sylhet airport, and various highways linked under the Padma Bridge framework⁸⁴⁴. Chinese company China National Machinery Import and Export Corporation has a 70 percent stake in 1,320 MW Payra coal-fired power plant, Bangladesh's largest, to be built at an estimated cost of USD 2.48 billion – and a China EXIM Bank loan of USD 1.96 billion⁸⁴⁵. Phase one came into operation in 2022. The two companies have also set up a joint venture to invest USD 400 million to build 500 MW of renewable energy projects⁸⁴⁶. However, reports indicate China EXIM Bank has pulled out of funding phase 2 of the project⁸⁴⁷. In 2019, violent clashes between Bangladeshi and Chinese workers led to the deaths of a Chinese and a Bangladeshi worker at the plant⁸⁴⁸.

Other infrastructure projects where China and/or its companies will be involved in are the USD 2.86 billion Marine Drive Expressway, USD 2.04 billion towards expanding and strengthening the power system network, a USD 1.76 billion dual-gauge rail line between Akhaura and Sylhet, the USD 1.39 billion Dhaka-Ashulia Elevated expressway, USD 1.32 billion towards strengthening the power grid, and USD 703 million in the Karnaphuli tunnel⁸⁴⁹. China and/or its companies also have heavily invested in Bangladesh's natural gas fields, with American company Chevron selling its three gas fields to a Chinese consortium for USD 2 billion⁸⁵⁰. The two countries are also building a 220 km long oil pipeline funded by China EXIM Bank. Besides infrastructure projects, a Chinese consortium made up of Shenzhen and Shanghai Stock Exchanges bought 25 percent stake in the Dhaka Stock Exchange at USD 125 million, with the consortium also providing USD 37 million in technical support. India's National Stock Exchange lost its bid to the consortium⁸⁵¹.

However, reports have indicated that much of the promised USD 24 billion in loans in 2016 have not materialized. By July 2019, China had disbursed only USD 981 million, with Bangladesh renegotiating several loans. Bangladesh also scrapped the USD 1.6 billion four lane highway between Dhaka and Sylhet project after China Harbour – the same company that built Hambantota port – was found to be bribing government officials⁸⁵². Bangladesh has decades of experience managing international aid and loans, working with a variety of bilateral and multilateral funders. The Economist Intelligence Unit predicted in 2019 that “it was likely only a fraction of the deals signed in 2016 would be implemented, given the country's history of financial prudence – and careful borrowing”⁸⁵³.

In regards to Chinese perceptions about Bangladesh, Padma Bridge offers an interesting exploration. One of Bangladesh's key projects, the Padma bridge railway link project spans 7.7 kilometres connecting the capital Dhaka to 21 southern regions across the Padma River. The total cost of building the project was USD 3.7 billion which started in 2015. The project was rejected by WB in 2012 after allegations of corruption, and Bangladesh then decided to build it using its own funds in 2015. China SOE Railway Major Bridge Engineering Group started construction in 2015. The bridge came into operation in 2022.

Just like in the case of Nepal's Pokhara airport being termed a key project under China's BRI despite not being included by Nepal under the initiative, the Padma Bridge too was termed by China as a BRI project. Bangladesh then had to clarify that it had paid for the entire cost of construction, while its MOFA said no foreign funds from any bilateral or multilateral funding agency had been used for its construction and that both Bangladeshi and foreign firms were engaged in the project⁸⁵⁴.

Bangladesh has shown an ability to balance the demands of both China and India as well as other partners in its quest for development. For instance, it cancelled a proposed agreement with China Harbor Engineering to build a deep-sea port at Sonaida, south of Chittagong. Japan then came up with a proposal to construct not just the deep-sea port but also four large coal power plants 25 km of Sonaida⁸⁵⁵. Japan proposed to fund 80 percent on easy terms, and thus the deal became more lucrative for Bangladesh as opposed to Chinese loans.

Similarly, in January 2023, reports indicated that both China and India would invest in the Mongla port in the south-west⁸⁵⁶. India had extended a USD 600 million LoC to upgrade the port, but had not appointed a contractor until late 2022. Meanwhile, under the 2016 deal, China had also committed to modernize the port at USD 400 million, but the funds were not forthcoming. After Delhi appointed the contractor, Beijing immediately confirmed to Dhaka it was willing to fund the project. Bangladeshi officials have said both countries will invest in different areas of the port, with Chinese investment going towards container terminals and delivery yards, while Indian funds will be used to build jetties, roads, and a residential complex. In terms of debt exposure, Bangladesh's external debt rose by 238 percent in the period between 2011 and 2021⁸⁵⁷. China accounted for almost 7 percent of the total external debt⁸⁵⁸.

Comparative analysis of Chinese Engagements in Nepal and other South Asian countries

Similarities in the engagements

Nepal's case in relation to the above countries' engagement with China offers both striking similarities and differences. All the countries are ranked similar when it comes to corruption levels. As per Transparency International Corruption Perception Index of 2021, Bangladesh ranks 26th, Pakistan 28th, Nepal 33rd and Sri Lanka 37th lowest from the bottom in terms of corruption. According to a Carnegie report published in 2021, weak institutions, fragile civil society and 'elite party politics' and frequent domestic political turbulences remains a common feature of China's engagement in South Asia⁸⁵⁹. Corruption remains a common theme across these countries, with or without Chinese engagement. Where Chinese presence makes a difference is through its willingness to adapt and further pre-existing practices of corruption in these countries. "By some accounts, almost a third of [Chinese-backed] projects are likely to be commercially and/or financially unviable but have been allowed because state institutions were unable to resist pressure from politically connected individuals who stood to benefit"⁸⁶⁰.

Another similarity that emerges out of normative practices in infrastructure development in South Asia is the delays such projects face, along with an escalation in costs and other issues such as land acquisition. The easiest manner in which corruption is practiced in infrastructure projects is bid rigging, or ensuring that the contract is awarded to preselected companies, whether because of prior favours and kickbacks or because of political favouritism.

All countries have seen a coordinated approach by Chinese interlocuters while engaging with their demands for infrastructure-fuelled growth. As seen in Nepal, Chinese SOEs have often taken the lead in furthering Chinese engagement, with official Chinese finance arriving to support a Chinese SOE-led project. China has also adapted itself to the electoral realities of democracies, with the announcement or inauguration of new projects timed for elections whose results may suit China in the future, as a KI with a research group said.

The conditionality factor is very much tied into Chinese loans, with every country awarding contracts to Chinese companies in projects backed by Chinese finance. The cross-country study found that political elites in each of the countries had often gone out of their way to bypass public procurement laws or ease the way for Chinese companies⁸⁶¹. Chinese SOEs, contrary to the narrative, actively bid and operate against each other, which can also further corruption practices inside the host country due to the competition to land contracts between the SOEs.

Another similarity is in how China emerged as an alternative source for finance for development projects that may be linked to certain political constituencies, but were not approved for finance by other multilateral institutions or bilateral partners. China remains an easier source of finance for these countries, although this element has been tempered from both sides – with China also emphasizing the profitability of its international lending in recent years, and countries in South Asia becoming wary after Sri Lanka’s experience (whether factual or not).

China has also shown to be remarkably adaptable in terms of cultivating the political constituencies within each of the countries. But at the same time, political constituencies within each of the recipient countries have shown remarkable progress in dealing with Chinese SOEs and other actors, often posing a tough stance on negotiations. Nonetheless, the fact remains that all South Asian countries analysed have institutional weaknesses, which Chinese SOEs have sought to capitalize on. “Institutions in South Asia do not have the robustness to push back against elite interventions,” a KI said.

As such, most negotiations and agreements with Chinese companies and interlocutors in South Asia remain opaque at best, and the maze of Chinese companies prevalent in all. The lack of transparency in Chinese investments is a common theme in the South Asian experience. This includes contract negotiations, loan agreements and repayment terms, and awarding of contracts.

Chinese investment in infrastructure in these countries revolves around energy and transportation sectors. This is a function of the Chinese technical expertise and lower costs that Chinese SOEs offer, which companies from other countries cannot match. Chinese funding, however, can hide the structural weaknesses prevalent in these nations’ economies, as seen in Sri Lanka and Pakistan. Meanwhile, black swan events such as the Ukraine war, the Covid-19 pandemic, the 2022 Pakistan floods etc. can reveal these foundational macro-economic weaknesses, and often intensify their impact on the economies. Although expanded trade is one of the intended goals of furthering Chinese engagement in these countries, all countries currently experience a negative trade balance in favour of China.

What has also been noticed both in Bangladesh and Nepal is China’s attempts to label a project as falling under the BRI framework when it wasn’t so. The Chinese ambassador to Nepal has said on record, “The projects that are being constructed in Nepal under BRI have three modalities. First, it is like Gautam Buddha Airport in Lumbini where ADB has invested and Chinese contractors have worked. Second, the modality of Pokhara Airport where China’s commercial loans and grants are there and the construction company is also

Chinese. And the third modality is like the Tribhuvan International Airport in Kathmandu. The responsibility of improving this airport has been given to a Chinese company and the cost will be borne by the Nepal government⁸⁶². Whether this definition was agreed upon by countries while signing the BRI agreement isn't clear, but what is clear is that China has determined the BRI framework to be flexible enough to include any project in which China and/or its companies have participated in some form or the other. For smaller countries in South Asia, this results in a difficult situation, especially since the other major power in the region, India, has expressed deep suspicions about the BRI's goals in South Asia.

Another similarity that can be noticed is the level of Chinese engagement in each of the countries, which has permeated down to the civil society level. As in Nepal, China has engaged with students, the media, civil society organisations and the security establishment in all the countries, thus emphasizing other strategic spheres of Chinese interests apart from commercial one. This has also resulted in official party-to-party ties between the CCP and South Asian political parties as seen in Nepal, and may in the long run be detrimental to democratic growth in the countries. Further, such political engagement also means China is not particular about the nature of the regime in particular countries, as seen in China's willingness to engage with both the monarchy and the republic in Nepal, with the Army in Pakistan, and with the Rajapaksa regime in Sri Lanka that was harshly criticized for its human rights abuses during the end of the Sri Lankan civil war. This suggests that the upholding of democratic values within a state is not a priority for China as long as its interests are met. "China's presence in South Asia is no longer predominantly economic but involves a greater, multidimensional effort to enhance its posture and further its long-term strategic interests in the region"⁸⁶³. As such, all countries analysed in this report have adhered to the One China policy, and have sided or seen to be aligned with China's views in the past few decades.

Another rationale behind South Asian countries' engagement with China is its presence as an alternative to other multilateral financial institutions. The global south is particularly wary of what they term "foreign interference", as well as the conditionalities that emerge when dealing with institutions such as the World Bank and IMF. A corollary to this is a traditional wariness of local actors towards American foreign policy goals in the region, which has both historical as well as contemporary truths to it. Combined with this is the fact that most countries in South Asia see China as an alternative to India's hegemony in the region. As such, an argument can be made that countries of the global south are constantly looking to maximise their potential by hedging one great power against the other, and by creating opportunities within the great power contests as well. "U.S. interest in and engagement with smaller South Asian countries is viewed locally as being sporadic at best. China, on the other hand, is perceived as a player with a plan"⁸⁶⁴. The countries

in the region do not view Chinese companies such as Huawei with the same levels of suspicion seen in the US and its allies. If anything, going by the discourse against the Indo-Pacific Framework in Nepal, one can argue such American moves at containing China's economic rise are seen to be prohibitory on part of the US.

Where China has also succeeded is in projecting its engagement in these countries – and the rest of the world – as one that does not impinge on their traditional sovereignty concerns, and positioning their economic engagement as one that benefits the populations of the host countries than China primarily. Whether this has to do with the historical experience of these countries vis-à-vis India and the US and other countries, or whether it has emerged from China's foreign aid practices during the Cold War, requires further study.

Differences in the engagements

The primary difference, as has been emphasized elsewhere, is the scale of investments in Nepal versus the other countries. China's economic interest in Nepal is limited, despite the narrative around them. Instead, its economic push inside Nepal is predicated on acquiring political and other levers of influence. Countries like Bangladesh and Pakistan have a much larger economy than Nepal, while even Sri Lanka's economy is about two and a half times bigger than Nepal's.

Also, Nepal's exposure to Chinese debt in terms of absolute value is far lower than those of the other countries. Even Maldives, which has a smaller economy than Nepal at USD 9 billion (2018), owed USD 1.5 billion to China. Nepal, on the other hand, owed China USD 287 million at the end of 2022. This critical point highlights the differences between Nepal and the other countries, is reflective not just in external debt conditions, but also Nepal's capacity to absorb financially large-scale projects. Nepal's aid experience also suggests it prefers a grant modality than even concessional loans, which is not the same as other South Asian countries.

Building up on the argument that Chinese engagement in Nepal is predicated on expanding its political influence, another critical difference between Nepal and other South Asian countries is the visible role of China – as well as other foreign actors such as India and, more recently, the US – in its domestic politics. The role of the Chinese envoy in trying to avert the split in the Nepal Communist Party marked a visible departure from previous nature of Chinese political engagements in Nepal. While such visibility is not immediately noticeable in other South Asian countries, China has spoken up on its core interests, such as during a proposed visit of the Dalai Lama to Sri Lanka in early 2023.

Similarly, Chinese military and security cooperation with Nepal is among the weakest in the region. While this is a result of Nepal consciously choosing to stay away from security-led

initiatives or military alliances as part of its foreign policy, China has consciously engaged with one security establishment that is essential to its interests in Nepal, viz. the Armed Police Force (APF), which is responsible for border security. This, of course, has to do with the fact that Nepal shares a long border with the restive Tibetan plateau.

Similarly, the BRI has yet to see any movement in Nepal, with none of the nine projects listed under it moving beyond the initial framework. On the other hand, all three countries analysed in South Asia have seen rapid forward movement on BRI projects. There is also a marked difference in how Nepal has approached project negotiations, especially in contrast to Bangladesh which has affirmed its will on projects funded by bilateral or multilateral partners. A lack of local technical expertise has meant Nepal has often signed up to projects where faulty design and lack of profitability are commonplace, especially with respect to Chinese-driven projects.

There is also a key difference in the political cultures of each of the states, and not just with Nepal. In Nepal, after the abolition of monarchy, political power has been shared between a few major parties with pan-national influence and a host of smaller parties with localized influence. This has resulted in unstable coalition politics that has seen multiple government changes and no single prime minister able to complete five-year-term. But this also means no political leader or party has been able to assert authoritative will on state institutions. In Bangladesh, political power is visibly divided between two political parties, but the current Awami League government is in its third consecutive term, while the opposition has been severely under pressure with large-scale arrests taking place. Thus, a stable regime has been built on the back of a silenced opposition. In Pakistan, the military plays a sizeable role in domestic politics, although there are similarities in the way certain ethnic groups have monopolized the state's institutions. In Sri Lanka, although recent street-led protests have challenged the traditional hegemony of the Rajapaksas, the constitution has been regularly amended to centralise more power in the office of the President.

Countries in South Asia share both similarities and differences with their experiences with Chinese finance, engagement and political influence. This was expected, both because South Asia shares commonalities in cultural and historical realms, but have also seen significant divergences in how the countries' political systems have evolved over time. One key factor, however, that is yet to be studied is the linkage between political and economic circumstances in one country and their impact in another. For instance, the Sri Lanka debt crisis has been constantly referenced by Nepali political actors who have insisted Nepal favour grants or softer loans than those offered by Chinese institutions at the moment. This is not about the 'debt trap' narrative entering the public realm, but to what degree circumstances in neighbouring countries affect the political discourse in another.

China as a challenge to Indian regional hegemony

The South Asian geopolitical framework had also for long been dominated by the India-Pakistan matrix. However, China's expanding footprint in the region has blunted India's traditional hegemony to a certain degree. What is notable is that while in the first decade of the 21st century Delhi's policies were intended to keep China out of the region, by the second decade, Delhi had come to realize that China was here to stay in South Asia, and as such, has recalibrated its approach to negating Chinese presence as far as possible. With the exclusion of Pakistan, almost every other country in South Asia has attempted to balance these two big players in the neighbourhood, with Nepal being the primary example of how big states can influence the agency of smaller states. But the reverse is equally true in South Asia – in that the choices smaller states make can often determine how big states present themselves in the country, as seen in India's emphasis on connectivity in Nepal after the 2015 blockade, which led to Nepal seeking out China as an economic alternative. Thus, it would be a mistake to assume small state choices are shaped by bigger actors. As simply we have seen, local political agency is also key to determining the choices smaller states make.

Where China has made a critical difference – and this is not just in South Asia but in other countries of the global south – is that it has appeared as an alternative source of finance to fuel the development ambitions of the global south. The stance that China lends easily with comparatively less prerequisite on the part of lender to access the credit, has proven to be more expensive may be held up by countries opposing China as an example of why less-developed countries (LDCs) should refuse Chinese money, but such a position ignores the fact that LDCs have development and economic aspirations. And their political leaders would like to address some of these aspirations to reap political benefits.

More importantly, China's perception as an easy source of finance has also resulted in domestic political constituencies in each of the countries showcasing China-led infrastructure development as a panacea for economic growth. But China's willingness to deal with both democratic and undemocratic states and institutions, as well as its manoeuvring of domestic politics to favour certain actors over others due to ideological or other affinities, has also resulted in alignments unfavourable to democratic practices. Transparency and accountability norms have often been bypassed, and the high levels of endemic corruption in South Asia mean China's financing of infrastructure can often lead to by-products that erode democratic values.

However, effective oversight and contract management are a function of a recipient country's institutions, and not China's. As a political scientist has termed it in Africa's

context, China is “filling the void” left behind by other states in infrastructure and investments⁸⁶⁵. The same could be said for South Asia as well.

China has felt the need to address questions around its fiscal disbursements and lending practices around the world. Debt relief has been a constant feature of the BRI, as documented in AidData’s March 2023 working paper, which reported that since 2000, China has rescue-lent over USD 200 billion to more than 20 countries as debt relief, with USD 185 billion being extended between 2016-2021 alone⁸⁶⁶. China has thus emerged as a ‘key lender of last resort’ for developing countries, with almost all bailouts having gone to “low- and middle-income BRI countries with significant debts outstanding to Chinese banks.”

The key questions around China’s engagement in infrastructure in the years to come, not just in South Asia but the rest of the developing world, will certainly revolve around China’s lending practices. But further study will be required to analyse how infrastructure development is pursued in these countries, as well as their negotiating skills and domestic political agency, and oversight mechanisms in the implementation of infrastructure development.

CHAPTER VI

Conclusion

Summary

Nepal's agenda of infrastructure development relies heavily on foreign actors, but there is a conflicting mix of motivations driving large projects. Domestic political demands and donor interests often overshadow accountability, transparency, and economic viability. Even projects catering to local demand, like aircraft purchases, are influenced by Nepali political actors, disregarding regulatory feedback and raising concerns about their viability.

Nepal lacks a clear infrastructure policy to prioritize projects and provide oversight, resulting in delays and other setbacks. The practice of awarding contracts to the lowest bidder, both locally and with international actors, has led to setbacks. This approach brings in low-quality contractors, leading to implementation issues, poor materials, and low completion rates. Collusion between contractors, politicians, and bureaucrats creates further problems, including time overrun, cost overrun, and subpar infrastructure. This collusion extends to larger projects funded by bilateral or multilateral partners, with local representatives of international construction companies playing a key role in swinging contracts through political and bureaucratic connections.

China's infrastructure engagement in Nepal, viewed positively by the local population, has raised governance issues due to a lack of transparency in awarding and executing contracts. Close ties between Nepal's Left parties and the Chinese Communist Party also undermine the country's non-alignment foreign policy goals, as overt political links influence the awarding of large contracts. The economic crises in Sri Lanka and Pakistan, resulting from questionable economic choices and unsustainable debt, have sparked concerns about China's alleged "debt trap" diplomacy. Nepal has become cautious about high-interest loans for large infrastructure projects. However, the idea of China's coercive debt practices has not gained much support within the country.

This report has outlined Nepal's historical and contemporary engagements in infrastructure with bilateral and multilateral partners, primarily focusing on China and its companies. This research has also outlined Nepal's traditional weaknesses in governance in infrastructure, beginning with its weak public procurement laws. The provision of awarding contracts to the lowest bidder as per Nepal's procurement regulations, both in local infrastructure projects as well as in projects led or funded by international actors, has resulted in several setbacks in infrastructure governance. Such practice has resulted in low quality of contractors, which spiral into deficiencies in implementation, quality of material, and completion rate. The existing nexus between contractors, politicians and bureaucrats has led to collusion between these actors, often leading to contract fixing in domestic infrastructure projects, which displays its own set of issues such as delays in completion, cost overruns, and low-quality infrastructure. Such a nexus also extends towards larger infrastructure projects funded by bilateral or multilateral partners, where the local representative of international construction companies – known as the 'agent' – has been seen to be key in swinging contracts through their political and/or bureaucratic connections. The agents are also known to be influential within key line ministries associated with contracts.

Drivers for large infrastructure projects in Nepal

Large infrastructure governance in Nepal suffers from an overwhelming dependence on foreign actors – both bilateral and multilateral. However, there remains a mixed motivation for large infrastructure projects, which is currently spurred by domestic political demands as well as interests of donors and political actors. In many cases, the donor or political actors' incentives drive the projects forward, turning a blind eye to accountability and transparency in the procurement process, economic viability along with sustainability of infrastructure projects. Even in the case of infrastructure projects that have been found to capitalize on local demand – such as in the case of PIA – the contract and procurement process have been influenced by Nepali political actors while ignoring critical feedback from regulatory authorities. In some cases – such as the purchase of Chinese aircraft – Nepali institutions have ignored critical information. Consequently, the operability of such infrastructure has been questioned on grounds of viability.

In case of hydropower projects, Nepal's long-standing potential in the sector means the sector has attracted great attention from both local private sector players as well as bilateral and multilateral actors. But a lack of focus on other complementary issues – land acquisition both for projects and for transmission lines; easing distribution to fulfil local demand; and export hurdles – have led to queries regarding the sustainability of such projects. Influencing procurement laws to favour certain developers and contractors in the sector have resulted in questionable delays and projects falling into disregard. Nepali politicians are found to be influenced by incentives of local agents and international

companies, leading to the selection of projects based on interest of certain lobbying parties, and irregularities in the project procurement. It has been found that sufficient checks and balances do not exist, and unless the mechanisms are strengthened to correct the culture of impunity, infrastructure in Nepal will continue to face such issues in the coming days. Nonetheless, the sector presents a most optimistic scenario for economic development in the country.

Nepal does not have a designated infrastructure policy that will allow it to determine and prioritize certain projects over others. Although it has labelled a number of projects as 'national pride projects', these have not received adequate oversight. Thus, almost all of the national pride projects in Nepal currently face delays and issues that are similar in nature. In the absence of such critical long-term thinking, several large-scale projects have moved forward without proper need assessments, resulting in haphazard allocation of resources in a capital-deficient nation. Nepal's recent multiple initiatives in international aviation infrastructure is a prime example of this. Nepali leaders have publicly professed to continue with another international airport in Nijgadh despite operational and sustainability issues surfaced in recently built PIA and GBIA. The Environment Impact Assessment Report of the proposed Nijgadh airport has already been questioned, signalling the irregularities in the project before its actual commencement. Nepal may see four international airports in the near future, all within a short distance of each other.

Our research has found that there is insufficient oversight mechanisms and accountability in the selection of large infrastructure projects. For instance, the new infrastructure projects such as the two new international airports in Bhairahawa and Pokhara are currently being under-utilized at the expense of the exchequer. However, the larger issue is a lack of transparency, not just in the processes that lead to the awarding of contracts, but also during the implementation of the contracts. While lack of transparency affects bilaterally funded infrastructure projects more than those funded by multilateral institutions – primarily due to the latter's guidelines – this research has shown that large infrastructure projects funded by China are notable for their lack of transparency, which is a function of such projects being motivated by the political relationship between China and Nepal's political class with the agents of Chinese companies acting as mediators.

China's infrastructure engagement in Nepal

Historically, China's engagement in Nepal's infrastructure was motivated by a desire to expand its political influence and containment of Indian influence, especially after the 1962 Indo-China war. Similar motivations can be seen in China's engagement in Nepali infrastructure in the 21st century but with subsequent increase in scale of engagement in recent years. China has also cultivated deep ties with the Left parties in Nepal, a

result of the post-monarchy vacuum that China felt in the country. For a longer period of history, China maintained relationships with the monarchs and after its abolishment, it saw Communist parties as a leeway to extend its influence in Nepal. China has deeply engaged with Nepal's governments when Communist leaders are in power. Almost every infrastructure project awarded to China and/or its companies after 2008 was awarded by a Communist leadership. As such, the argument that the Nepali Left's political relationship with China is driving the latter's infrastructure engagement in Nepal is validated.

China's infrastructure engagement in Nepal – as in other developing countries in South Asia and the rest of the world – is viewed positively by the local population linking it to the prospect of economic possibilities and their potential for growth and prosperity. However, such engagement has raised governance issues inside Nepal. Lack of transparency both during the awarding of infrastructure contracts as well as around the execution of infrastructure projects has strengthened the culture of systemic corruption. Irregularities around procurement process can be seen in almost every large infrastructure project, including the Kathmandu-Terai Fast Track Road project spearheaded by the Nepal Army and has been contracted to Chinese companies. A lack of oversight and lack of scrutiny over design and operability issues can be seen in several other projects such as the Kathmandu Ring Road expansion project and Nepal Airlines' purchase of Chinese aircrafts. This also signals the weakness of Nepal's state institutions, which have often proceeded with infrastructure projects and procurements despite visible design and operability issues.

Further, the lack of transparency around Chinese infrastructure engagement is also related to the labyrinthine ownership and holding structures of Chinese companies. Most Chinese companies do not engage with the larger public, instead allowing the political relationship to drive the projects forward. There are very few sources and research available on Chinese companies engaging in infrastructure contracts inside Nepal in the public domain, and the maze of Chinese companies' ownership structures are opaque. In countries like Nepal with weak state institutions, high level of existing corruption and lack of transparency magnifies existing structural weaknesses by promoting non-accountability in large projects.

The close links between the Left parties and the CCP also hinder Nepal's professed foreign policy goal of non-alignment, especially when explicit political links between the two parties and their leaders lead to the awarding of large infrastructure contracts. There is also very little room within the government to critique Chinese engagement around the issues of transparency and accountability, and those who did have often found themselves at the receiving end of punitive action. Similarly, such scrutiny is not often to be found in the media either. Such close links between Nepali political actors and their Chinese counterparts, and Chinese companies and their local agents also raises the concerns of the

driving factors behind large infrastructure projects in Nepal developed by or contractually awarded to Chinese companies.

China's professed preference for Left parties in Nepal also means an erosion of the Nepali democratic space, which will result in a lopsided foreign outlook that may not necessarily be the best way forward in a time of current great power contest. Already India's restrictions on Chinese investments in Nepal's power sector means Nepal will have to look for alternative futures, but an alignment between Nepal's political class and China might restrict Nepal's foreign policy choices. This is particularly key in the power sector, which holds great hopes for bringing in much-needed export revenue.

The debt-trap dilemma

The economic crises in Sri Lanka and Pakistan, as a result of questionable economic choices made by local political leaderships which led to unsustainable external debt, initiated a public discourse on 'debt trap' diplomacy allegedly practiced by China through its lending practices. The dire economic situations of both countries have resulted in an overall wariness in Nepal towards funding large infrastructure projects with the help of high-interest loans. But the idea that China practices 'debt trap diplomacy' as a coercive measure has not found any buy-in inside Nepal. While Nepali political leaders, particularly those not from the Left, have signalled to China that Nepal would not prefer more loans on infrastructure projects, the key question is around infrastructure operability and viability.

Nepal's long experience in negotiating with multilateral institutions on finance and other terms have given it a critical agency that have led its officials to reject large infrastructure projects it has deemed unviable. However, this latter agency is often overshadowed by political actors, who are motivated by various partisan interests in driving certain infrastructure projects ahead. Nonetheless, strengthening the negotiating skills of Nepali state actors will be an additional element in strengthening infrastructure governance in Nepal.

Chinese engagements vis-à-vis other infrastructure partners

Nepal's historically weak internal revenue collection necessitates an engagement with bilateral actors and multilateral institutions to supplement its development goals. Foreign actors have historically played an important role in infrastructure development in the country. Besides China, Nepal's southern neighbour, India, has traditionally played an important role in infrastructure development, along with Japan. However, bilateral infrastructure engagement can be said to possess certain conditionalities, with the preference for contracts being awarded to companies and institutions from the respective bilateral partner. Bilateral engagement in Nepali infrastructure can also be said to follow the

contours of the political relationship between the respective partner and Nepal, particularly in the case of India and China. The two neighbours' larger rivalry has also been reflected in Nepal's infrastructure development with changing paradigms of engagement over the years, and potential discouragement of rival country's companies in the infrastructure awards. A tit-for-tat response towards infrastructure in Nepal has also been a historic paradigm in its two neighbours' engagement in Nepal, as seen most recently in the Tibet-Kathmandu train line, and India's response being the Raxaul-Kathmandu train line. This can often result in infrastructure development inside Nepal being determined by external factors rather than local needs.

Bilateral assistance forms less than a third of Nepal's external assistance, with the majority of external assistance coming from multilateral institutions, primarily the World Bank and the ADB. The latter, in particular, is heavily engaged in infrastructure in Nepal, especially in the hydropower, road transport and aviation sectors. Projects with multilateral involvement can be said to have more oversight, but primarily due to the institution's international norms. Nonetheless, delays, faulty contractors and cost overruns have remained a feature of such projects, the involvement of multilaterals notwithstanding. Multilateral institutions thus also need to strengthen their oversight mechanisms in such projects.

China's infrastructure engagement in Nepal vis-à-vis South Asia

China's infrastructure engagement in Nepal has followed similar paradigms of its engagement in other South Asian countries such as Pakistan, Sri Lanka and Bangladesh, but with notable differences. While China's close links with the political class are common to all countries in addition to the common risks associated with weak state institutions, prevalence of corruption, and lack of accountability, there are two key differences. The first is the magnitude of borrowing and investments from China, which in Nepal is at a much lower scale than other countries in South Asia – and thus at the lower scale of exposure to Chinese debt. This has to do with the size of the respective economies too, but even when compared with Maldives, which owes more than USD 1 billion to China with a national GDP of USD 5 billion⁸⁶⁷, Nepal's exposure to Chinese debt remains miniscule. It can be argued that it is also an outcome of Nepal's low capital absorption capacity as Nepal's annual development budgets often fall heavily short of their capital expenditure targets. The second is China's security relationship with other countries which has driven infrastructure engagement in the rest of South Asia, but it is noticeably missing in Nepal. Whether this is due to Nepal's land-locked status, or due to China's security goals in Nepal being different from other countries in South Asia will require greater study.

Going ahead

The infrastructure sector in Nepal will require key structural reforms to improve its governance. Chronic underspending of the budgetary capital expenditure remains a key feature, and almost all infrastructure projects deemed ‘national pride projects’ have seen cost and deadline overruns. The World Bank estimates Nepal needs to spend at least 10 to 15 percent of its GDP annually in the next decade to meet its infrastructure needs, but dependence on public infrastructure – and an inability to reform the sector to invite private developers beyond contractual obligations – means this target will be a challenge for Nepal to achieve⁸⁶⁸. Further, regulatory hurdles prevent market competition, allowing for low-quality contractors to continue receiving new contracts despite their poor delivery record, pointing to a collusion between such contractors and state institutions.

Beyond strengthening infrastructure governance mechanisms to ensure timely implementation and operationalization of infrastructure projects, Nepal must reform its public procurement process. The preference for the lowest-cost bidder is a hurdle, which judges bidders primarily on the basis of cost. This mechanism allows for low-quality contractors to win the contracts – and in Nepal’s case, on a regular basis. An alternative to this method must be sought, despite arguments that cost is the most important determinant of an infrastructure project.

Increased Chinese engagement in Nepali infrastructure has often been seen as an opportunity to fulfil Nepal’s development agenda. The political class – primarily the Left – has often used such prospects as electoral promises, thus raising the expectations of the Nepali public. China’s own development story has also been held up as a model of extricating a nation’s population from poverty. But its story in Nepal needs more nuance than such simplistic explanations. While China has emerged as a key alternative for capital for developing nations such as Nepal, this has to be taken in consideration with the reluctance of other bilateral partners to engage in Nepal’s infrastructure beyond limited goals. The international finance market has also been difficult to access with Nepal’s rudimentary institutions and regulations. This has created a welcoming environment for Chinese engagements in the infrastructure sector in Nepal.

China’s technical expertise, along with the fact that Chinese capital doesn’t ask too many questions, or find it strictly demanding on social and environmental impact assessments, or is motivated by the larger political relationship, certainly make Chinese capital more attractive to Nepal’s political class. But unless proper oversight mechanisms and transparency and accountability mechanisms can be established, such capital will lend itself to the weakening of Nepal’s institutions, as seen in the case of the Nepal Airlines’ purchase of Chinese aircraft which has left an already loss-making public entity on the verge of collapse.

The current climate of impunity in Nepal remains the major hurdle to address the regulatory shortcomings and corruption in infrastructure governance. The collusion between local 'agents', politicians, bureaucrats and international companies – and the resultant corruption – has been occasionally uncovered by the Nepali media. But beyond the political class and the bureaucracy paying lip service on the issue of corruption, those implicated in corruption scandals have continued to operate with impunity. Crony capitalism has, in fact, been encouraged by such impunity, with most corruption cases featuring family members or associates of politicians. Perhaps the best instance of such impunity is the appointment of a contractor – with dubious record – as the minister for physical infrastructure, or the awarding of contracts to a Maoist leader's landlord – there are far too many instances from the recent past to recount here. Such impunity is then extended to Nepal's political class's dealings with bilateral actors such as China, wherein ministers and political leaders have often sidestepped Nepal's regulatory mechanisms and ensured contracts are awarded to companies through a pre-determined agreement. Often such contracts take the cabinet route, thus ensuring they cannot be critiqued or investigated by the anti-graft government body. There are also several instances of ministers and politicians caught on record asking for kickbacks, but once again, the culture of impunity has allowed a proliferation of corruption.

While infrastructure projects funded by multilateral institutions often have better oversight, there have been delays and other issues associated with such projects too. Donor motivations have often been questioned in such projects. But the most noticeable observation has been a reluctance on the part of multilateral institutions to both call for reforms in infrastructure governance, as well as reducing Nepal's dependence on foreign assistance. While Nepal's power sector has seen a few investments in equity from multilateral institutions, a lot more needs to be done in other infrastructure sectors if all-round improvement is to be seen.

As a developing country with difficult geographical terrain, Nepal faces a massive infrastructure deficit. While this fact has been widely recognized by all concerned, the quality of infrastructure remains questionable due to the many factors outlined above. Mitigating these issues – while addressing the infrastructure deficit – will require an overhaul of Nepal's governance mechanisms in infrastructure. Unless these issues are resolved, the quality of Nepali infrastructure will remain poor in the years to come.

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