

Monitoring Brief 3

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Ongoing Negotiations with China on BRI and Infrastructure Investment

1. Background and Introduction

Nepal and China have been engaged in diplomatic negotiations on the Belt and Road Initiative (BRI), Chinese development cooperation and infrastructure development. Since signing the BRI framework agreement in May 2017, the two nations have been working to finalize an implementation plan for the ambitious initiative.

While China envisions the BRI as a catalyst for regional connectivity and economic growth, Nepal has expressed reservations about the terms, particularly concerning the nature of financing and BRI's inclusion of other sectors, including security. This has led to protracted discussions, with Nepal seeking to balance its need for infrastructure development with concerns over national priorities, debt sustainability and regional security implications. The broader geopolitical dynamics in the region, including India's stance on BRI, also influence the trajectory of Nepal-China negotiations.

This monitoring brief discusses the current status of four key infrastructure-related initiatives currently under negotiation between Nepal and China:

- BRI Implementation Plan,
- Trans-Himalayan Multi-Dimensional Connectivity Network (THMDCN),
- the second phase of Ring Road Improvement Project, and
- Nepal-China Friendship Industrial Park in Damak.

This brief also discusses potential outcomes and implications of these initiatives.¹

¹ The claims and statements made in this issue brief are based on media reports and interviews with several senior Nepali politicians (including former foreign ministers) and senior government officials (including former foreign secretaries). We are not quoting any of these leaders or officials as per their request.

2. Key Issues

2.1 BRI Implementation Plan

China's early flexibility. Nepal and China signed the MoU on Cooperation under the Belt and Road Initiative in May 2017, just a few days before the BRI Forum in China. As it wanted Nepal to sign the agreement before the BRI Forum, China consented to Nepal's requests for revisions.

Chinese Pressure. Nepal is under a lot of pressure to implement the BRI, which has stalled since its signing. In October 2021, China pushed for the "Implementation Plan on Jointly Building the BRI Between the Government of the PRC and the Government of Nepal." The then Deuba government refused to sign the BRI Implementation Plan due its reservations on components related to security and strategic issues.²

Current Status. The BRI Implementation Plan was revised by the National Planning Commission and sent back to the government in September 2023. The government was expected to sign the agreement on September 15, 2023 a few days before PM Prachanda left for New York and then to China. However, the cabinet failed to approve the plan after (geo)political pushback. PM Prachanda's government made another unsuccessful attempt to sign the agreement in June 2024 a few weeks before he was forced to step down from office.

Issues and Positions

Positions of Nepal and China on the BRI have been divergent. Nepali officials and political leaders have indicated reservations about funding modality, China's push for "policy exchanges". During the recent negotiations that led to joint draft of the document, some contentious "security and strategic issues"³ were dropped from the Chinese draft.

In March 2022, the then Prime Minister Sher Bahadur Deuba told China's Foreign Minister Wang Yi that Nepal cannot take loans with high interests and the modalities and conditions (eg, interest rate, repayment schedule, procurement conditions, competitive bidding) should be comparable to the loans from bilateral and multilateral lenders. Recently there is increasing consensus among political parties in Nepal to opt for grants and soft loans in par with other IFIs, if Nepal has to implement projects under BRI.

2.2 THMDCN

A Framework under BRI. The Trans-Himalayan Multi-Dimensional Connectivity Network (THMDCN) is a broader framework under the BRI that aims to expand China's market access to India through Nepal. The joint statement after PM Oli's visit in 2018 said the two sides had agreed to

²<https://kathmandupost.com/national/2023/09/14/signing-of-bri-implementation-plan-uncertain>

³ <https://kathmandupost.com/national/2023/09/14/signing-of-bri-implementation-plan-uncertain>

“enhance connectivity, encompassing such vital components as ports, roads, railways, aviation and communications within the overarching framework” of THMDCN.⁴ The same was reiterated in the joint statement after Xi Jinping’s visit to Nepal in October 2019.⁵ In September 2023, when PM Dahal visited China, the THMDCN gained renewed prominence.⁶

The connectivity framework aligns closely with China’s BRI vision. According to the recent draft of the BRI Implementation Plan, “Transport, Connectivity and Logistics” is its number one priority.⁷

Dahal’s cabinet’s approval. Dahal’s commitment to the Chinese connectivity network was reflected in his decision to approve its MoU through a cabinet decision on July 11, a day before being forced out. The MoU was named “Strengthening the Development Cooperation in Building The Trans-Himalayan Multi-Dimensional Connectivity Network.”⁸ The MoU has not been made public; efforts by journalists to get more information about the said MoU has not been successful.

Nepal’s concerns. Details about the THMDCN are not available and there is no clarity about what it entails. However, concerns have been raised about debt sustainability, geology, and technical feasibility. For example, a core component of the THMDCN is the Gyirong-Kathmandu rail project project, which is expected to cost around \$4.8 billion USD (over 10% of Nepal's GDP). THMDCN has also raised concerns about financial viability and strategic implications for Nepal.

2.3 Ring Road Improvement Project (Second Phase)

Delays. Nepal and China signed a MoU on the second phase of the Kathmandu Ring Road Improvement Project in February 2018. According to the MoU, the expansion was supposed to be completed in two years. However, Nepal and China (CIDCA) are yet to sign the project implementation agreement for the second phase, without which the project can not move ahead.

China submitted a draft of the exchange note only in March 2024, after a series of demonstrations and protests in Kathmandu, some led by Mayor Balendra Shah. Once the agreement has been signed, it

⁴ <https://mofa.gov.np/joint-statement-between-nepal-and-the-peoples-republic-of-china/>

⁵ <https://mofa.gov.np/joint-statement-between-nepal-and-the-peoples-republic-of-china-2/>

⁶ <https://mofa.gov.np/joint-statement-between-the-peoples-republic-of-china-and-nepal/>

⁷ The draft of the Implementation Plan lists the cooperation priorities in the following order: 1) Transport, Connectivity and Logistics; 2) Trade, Industrial Capacities, and Investment; 3) Economic and Financial Sector; 4) Education, Science and Technology; 5) Intellectual Property, Measurement, Standards, and Conformity Assessment; 6) Agriculture, Forestry, and Water Conservation Sector; 7) Energy Saving and Environment Protection; 8) Geoscience Sector; 9) Customs Clearance; 10) Health Sector Cooperation; 11) Cultural and Tourism Exchange; 12) Other Areas, which includes developing relations between think-tanks, media, non-governmental organization, and political parties.

⁸ <https://nagariknews.nagariknetwork.com/politics/1441744-1720701156.html> Also see <https://www.ratopati.com/story/436420/government-decides-to-list-humlu-caste-as-tribe>

will take another six months for China to submit the DPR of the project, and another six months for the procurement of a contractor.⁹

Uncertainty and protests. Despite the mounting pressure and repeated Chinese assurances to begin the project's construction, the expansion of Kathmandu's Ring Road appears uncertain. Although the Chinese side has communicated to have allocated "dedicated budget for the second phase of the Ring Road expansion, they have "not disclosed the allocated sum with Nepali officials."¹⁰

Responding to increased public pressure, the Department of Roads (DoR) Nepal issued a statement saying Nepal had received an exchange note from the Chinese side on March 20, 2024 regarding the project and preparations are being made to sign the Exchange of Letter between Nepal's Finance Ministry and the Chinese side."¹¹ During the visit of CIDCA Chairman, Luo Zhaohui, Nepali officials said the project, to be funded by CIDCA, was in the final stage of negotiation.

2.4 China Nepal Friendship Industrial Park

In October 2019, the Investment Board of Nepal (IBN) signed a Memorandum of Understanding (MoU) with China's Lhasa Economic and Technological Development Zone, Jing-Ping Joint Creation Construction Project Development Co. Ltd,¹² which would develop the park with an investment of NPR 64.41 billion approved for first phase of the project. On February 28, 2021, then Prime Minister KP Sharma Oli laid the foundation of the park.¹³

In August 2023, IBN decided to establish a committee for final negotiations with the developer and develop the Project Development Agreement (PDA). However, even after approval of the DPR by IBN, the negotiations on the PDA is said to be ongoing.

According to reports and interviews, one of the key points of contention in the negotiation is the differences regarding the concessional period. Nepali laws allow a 30-year concessional period, however, the Chinese developer has been demanding 40 years. Due to the proposed park's proximity with both India and Bangladesh, it is seen as an important project that would allow China to tap into the South Asian market.

3. Potential Outcomes and Implications

All of the above infrastructure-related initiatives reflect significant obstacles and challenges. Resolution of the challenges requires broader and in-depth understanding among Nepal's policy

⁹ <https://www.nayapatrikadaily.com/news-details/143769/2024-06-22>

¹⁰ <https://kathmandupost.com/national/2024/06/12/nepal-to-seek-action-on-chinese-pledges-at-bilateral-meeting>

¹¹ https://www.dor.gov.np/uploads/ckfiles/files/DOR_Notice.pdf

¹² <https://old.risingnepaldaily.com/nation/ibn-signs-accord-on-clean-industrial-park-in-state-1>

¹³ <https://theprint.in/world/nepals-damak-industrial-park-under-chinas-bri-now-centre-for-local-agitation/1367099/>

makers and the broader society. It also requires more informed and unified negotiations between Nepal and China.

BRI affecting development cooperation

BRI Implementation Plan is of the highest priority for the Chinese and they have repeatedly told senior political leaders that signing of the Plan will open the door for all kinds of economic cooperation and assistance.

During his visit to China in 2023, PM Prachanda requested China to provide grant for a few big projects. However, China said signing of the BRI Implementation Plan was a precondition for China providing grants. Senior Nepali officials and politicians believe Chinese aid has now been tied to signing of the BRI Implementation Plan and Chinese development cooperation now hinges on diplomatic negotiations and the consent of senior Chinese leaders.¹⁴

China's priority and strategy of connecting to South Asia

China has been investing heavily in cross-border trade and connectivity infrastructure in Tibet, including in port towns along Nepal-China border. For example, China has invested almost USD 6 billion to develop Shigatse City's Economic Development Area, which is intended as a "gateway to China" for South Asian countries (Nepal, India and Bhutan). In case of Nepal too, the transport infrastructure component of THMDCN (rail and roads) can become financially viable only if they can be used to connect Tibet with India.

The level of current investments in infrastructure along Nepal-China border, and China's emphasis on THMDCN, indicates that China is confident of gaining access to the Indian market in the longer term and/or it sees THMDCN benefitting China's extended interests (including benefit for Chinese companies).

Geopolitics

Given the current state of relations between India and China, Indian policy makers are reluctant to allow China access to the Indian market through Nepal. At least three Indian experts whom we talked mentioned that China getting access to the Indian market through Nepal is a pipedream and is not geopolitically feasible. The hydropower sector in Nepal is a visible example of how India discourages market access to Chinese companies.

¹⁴ This information is based on interviews with several senior government officials and politicians, who do not want to be named.

Ring Road Delay tied to BRI?

The delay in the phase 2 of the Ring Road Improvement project indicates intentional delay by China, given that it submitted a draft of the letter of exchange only in March 2024, six years after the initial agreement. Senior officials believe that progress on Ring Road Phase 2 depends on Nepal's decision on BRI.

Industrial Park's future depends on access to Indian market

Part of Chinese BRI strategy in Nepal is to access the South Asian market. The design of the Damak industrial park also indicates that the project's feasibility depends on its ability to access the South Asian market. However, India's reluctance to open its market for Chinese goods, as demonstrated by its decision not to import hydroelectricity with Chinese investment, suggests that the Chinese developer's concerns about the project's financial viability are not unfounded.

Declining Chinese grants

China's grant/financial assistance has dried up since 2013. According to the Finance Ministry database, besides the earthquake reconstruction and relief assistance which is also far below the committed amount, China did, however, provided loan between 2016 and 2019 for the construction of the Pokhara International Airport; even in this case, China has only disbursed USD 124,814,540 to Nepal, out of the committed USD 212,916,857.¹⁵

At present, Chinese Development Cooperation is mostly limited to small-scale aid in northern 15 districts called Northern Area Infrastructure Development and Livelihood Improvement Project. It is being implemented by China International Development Cooperation Agency (CIDCA) with an investment of 20 million RMB (USD 2.8 million). According to newspaper reports¹⁶ TAR government will provide another 20 million RMB (about USD 2.8 million) every year for the next five years starting in 2024 for the development aid in northern districts.

A cabinet decision of July 4 approved the LoEs for the feasibility study of the Hilsa-Simkot Road, an Inland Clearance Depot/Integrated Check Post in Korala of Mustang, and maintenance of Araniko highway. These projects will be implemented by CIDCA.

5 Future Outlook

- In the long term, Nepal needs to **address issues of negotiations capacity, external influence, and corruption** in its relations with China.

¹⁵ Aid Management Information system for Nepal, Ministry of Finance, GoN, 2024

¹⁶ <https://kathmandupost.com/national/2024/05/03/tibet-to-provide-financial-aid-to-nepal-s-northern-border-districts-for-five-years>

- In the short term, Nepal must quickly **resolve the issue of BRI Implementation plan** in order to engage with China on other matters of national priorities, including Chinese development assistance and grants.
- Nepali senior policy makers and members of the parliament should **define national interests vis-a-vis BRI, take a unified stance, and communicate its position strongly to China.**
- Regarding the Ring Road Improvement Project, senior government officials and experts suggest that Nepal should **consider implementing the Ring Road project on its own** rather than waiting for China.
- **Address issues of information gap and lack of transparency.** Details about the BRI Implementation Plan, Ring Road, and THMDCN are not available publicly. Policy makers in Nepal, especially members of the parliament should demand more transparency about these issues. They should also start discussing the environmental and geological aspect of THMDCN, which has not been explored.