

Policy Brief

November 2024

BRI in Nepal: Status, Challenges, and Way Forward

1. Current Status of Nepal-China Relations: Key Features and Trends

Nepal and China share a historically robust relationship, marked by strong economic, cultural, and people-to-people ties. Nepal joined China's flagship Belt and Road Initiative (BRI) in 2017, signaling a new era of bilateral relations. However, progress has been slow due to Nepal's political instability, lack of national consensus, weaknesses in negotiation capacity and geopolitical challenges.

Amid the stalemate in BRI implementation, China is keen to portray the success of BRI in Nepal. Nepal's concerns over debt sustainability, sovereignty, and public skepticism about Chinese influence have emerged as significant challenges in advancing bilateral cooperation.

Engagements under the BRI umbrella: China is gradually transitioning its overall engagements in Nepal under the BRI framework. It fits into China's priorities under BRI: policy coordination, infrastructure connectivity, unimpeded trade, financial integration, and people-to-people bonds.¹

Delayed disbursement of committed grants: Chinese development assistance has declined significantly since 2013, with over Rs 100 billion in committed aid pending disbursement. This includes Rs 56 billion committed during Xi Jinping's 2019 visit² and Rs 15 billion promised during the 2022 Foreign Minister's visit³.

Strategic interest in leveraging Nepal as a transit hub: China's strategic interest in Nepal includes leveraging Nepal as a transit hub to access South Asian markets.⁴ This objective is exemplified through projects like the Trans-Himalayan Multi-Dimensional Connectivity Network (THMDCN), which aims to establish seamless trade and infrastructure links.

Geopolitical sensitivities: Nepal's engagement with BRI is complicated by geopolitical sensitivities involving India and the United States. Both nations view China's growing influence in Nepal with caution.

¹ <https://www.weforum.org/stories/2023/11/china-belt-road-initiative-trade-bri-silk-road>

² <https://cn.nepalembassy.gov.np/bilateral-relations/>

³ <https://kathmandupost.com/national/2022/11/16/nepal-china-seal-a-deal-for-utilisation-of-rs15-billion-in-chinese-grant>

⁴ http://www.xinhuanet.com/english/2021-03/05/c_139786036.htm

Focus on “small yet smart” projects and public engagements: China has emphasized smaller-scale, community-oriented projects under the Belt and Road Initiative in Nepal.⁵ These initiatives aim to build goodwill through soft sectors like education, healthcare, and cultural exchanges while fostering closer ties between the two nations.

Deepening party-to-party relations and policy exchanges: China has strengthened its relationship with Nepal by facilitating direct exchanges between political parties.⁶ These interactions, including leadership visits and training programs, aim to align political priorities, promote policy exchange and enhance mutual understanding. China views leftist forces in Nepal as a leeway to promote its interests.

Unilateral border decisions: China’s unilateral border closure has caused concerns in Nepal, highlighting a need for transparent dialogue.⁷ These decisions underline the importance of ensuring border management through bilateral consensus.

2. Nepal’s Stalled Negotiations over BRI: Current Status and Weaknesses

After signing an MoU under BRI cooperation in 2017, China sent the first draft of the implementation plan in 2020.⁸ However, Nepal has failed to reach a consensus on the plan. Disagreements over financing modalities—Nepal’s preference for grants over China’s emphasis on commercial loans—have stalled progress. Previous CESIF study notes contentious provisions, particularly policy exchanges, free trade agreement, and use of national currencies, among others.⁹ Political instability and lack of consensus among major parties have further complicated negotiations.

Key weaknesses in Nepal’s diplomacy include:

Insufficient understanding of BRI: There is an insufficient understanding of the BRI in Nepal, including its objectives, mechanisms, and implications. BRI has evolved from a connectivity project, to become one of China’s key foreign policy instruments.¹⁰ It is an umbrella initiative for China’s overseas engagements inducing strategic and geopolitical implications.

Insufficient preparation: Nepal has conducted minimal groundwork to assess the financial, legal, and strategic implications of BRI projects. This lack of preparation has led to unclear priorities and limited capacity to negotiate terms that align with national interests.

Fragmented political consensus and lack of unified national stance: Divergent views among Nepal’s major political parties, such as the Nepali Congress and CPN-UML, have delayed the

⁵ <https://kathmandupost.com/national/2022/12/17/undp-partners-with-chinese-ngo-for-the-first-time-in-nepal>

⁶ https://www.idcpc.org.cn/english2023/11dt/202311/t20231129_162977.html

⁷ <https://myrepublica.nagariknetwork.com/news/china-closes-both-main-border-crossings-with-nepal/>

⁸ <https://kathmandupost.com/national/2024/11/22/taskforce-begins-review-of-chinese-draft-of-bri-plan>

⁹ <https://cesifnepal.org/stalled-road-to-north>

¹⁰ <https://www.cfr.org/backgrounder/chinas-massive-belt-and-road-initiative>

formulation of a cohesive national stance on BRI engagements. The parties should create a unified stance on foreign policy for improved negotiations and policy decisions.

Geopolitical pressures: Nepal's efforts to balance its relations with India and the United States—both intent on containing China's growing influence—have complicated its approach to BRI. These pressures undermine Nepal's ability to focus solely on its development priorities when negotiating with China.

Negotiation capacity: Nepal has struggled to assert its interests effectively during BRI negotiations, particularly concerning loan terms and project prioritization. This limitation often results in agreements that do not fully safeguard Nepal's economic and strategic interests.

Institutional gaps: The absence of a dedicated agency to manage BRI-related negotiations has created significant institutional weaknesses. This gap undermines strategic clarity and Nepal's ability to systematically oversee project implementation and ensure alignment with national priorities.

3. BRI Implementation Plan: Key Features and Concerns

The proposed BRI implementation plan includes major infrastructure projects such as the Kathmandu-Kerung railway, open e-commerce, cross-border transmission lines, industrial parks, and road upgrades. It also emphasizes broader cooperation in trade facilitation, financial integration, and people-to-people exchanges, and states to support Nepal's development efforts under the BRI by providing 'financial and governmental assistance'.

Key concerns of the plan include:

Transparency deficit: The lack of public consultation and parliamentary debate on the BRI implementation plan undermines trust among stakeholders. Greater transparency is crucial to ensure that the provisions align with public interest and maintain accountability.

Debt sustainability: There is a significant fear that Nepal could face unsustainable debt levels, akin to Sri Lanka's experience with the Hambantota Port. Large-scale borrowing under the BRI framework, especially through high-interest commercial loans, or for unfeasible projects, could burden Nepal's economy for decades.

Ambiguous commitments on BRI forums: The plan includes numerous forums regarding BRI that Nepal is expected to join. However, there is little clarity about their scope and implications. This has created uncertainty about commitments.

Sovereignty risks: Provisions for Chinese oversight in key sectors, such as economy, commerce, infrastructure, energy, security, agriculture and Himalayan ecology raise concerns about Nepal's autonomy. These risks highlight the importance of ensuring BRI implementation does not compromise national decision-making power.

Limited local participation: The dominance of Chinese state-owned enterprises (SOEs) in BRI projects could marginalize Nepali businesses, reducing opportunities for local contractors and workers. This approach may also undermine the long-term development of Nepal’s domestic industries.

Geopolitical risks: Projects like the Kathmandu-Kerung railway under THMDCN are viewed as a part of China’s broader strategy to access Indian markets. The current constraints in Sino-India relations have created sensitivities in the region and could pose a greater geopolitical risk to Nepal. Such initiatives could heighten tensions between Nepal and its southern neighbor, India, complicating Nepal’s foreign relations.

Economic model mismatch: The provision of an “enterprise-led, market-oriented, and government-guided” economic model conflicts with Nepal’s economic framework. This approach could marginalize local businesses and increase dependency on Chinese enterprises.

Environmental and Social Safeguards: Insufficient attention to environmental and social safeguards in BRI projects could result in adverse impacts on Nepal’s natural ecosystems and local communities. Incorporating rigorous environmental impact assessments and inclusive social planning is essential to mitigate these risks.

4. Global BRI Experience: Lessons and Emerging Trends

With 151 partner countries and investments exceeding \$1 trillion,¹¹ BRI epitomizes China's global strategy. More recent trends in BRI projects feature a shift toward sustainability, smaller scales, increased private sector participation, and a stronger focus on ESG safeguards.

Regional BRI experience: Success Stories and Challenges

- Southeast Asian countries have successfully negotiated better terms through project-specific negotiations and focus on financial viability.¹² Indonesia's success with Chinese investments, such as the Jakarta-Bandung High-Speed Rail project, lies in securing favorable terms without government guarantees and fostering joint ventures for technology transfer.¹³
- African experience shows the importance of clear national goals, regional coordination, and alignment with domestic priorities. Zambia saw billions of dollars in infrastructure financing and it helped to accelerate economic growth.¹⁴ However, it also raised foreign interest payments to unsustainable levels, forcing cuts in healthcare, social services, and agricultural subsidies.

¹¹ <https://greenfdc.org/china-belt-and-road-initiative-bri-investment-report-2023/>

¹² <https://carnegieendowment.org/posts/2023/12/how-has-chinas-belt-and-road-initiative-impacted-southeast-asian-countries?lang=en>

¹³ Ibid

¹⁴ <https://www.wilsoncenter.org/blog-post/debt-distress-road-belt-and-road>

- South Asian experience highlights the need to prioritize projects that deliver long-term benefits while aligning with local goals and ensuring sustainable financing. Sri Lanka’s experience reveals the unsustainability of high-interest loans and the corruption associated with major infrastructure projects. Similarly, Bangladesh’s experience shows issues such as corruption and non-viable projects that fail to generate intended outcomes.

Recent Trends of Investment

Emerging trends include China’s shift toward smaller-scale projects that emphasize sustainability, local partnerships, and digital connectivity.¹⁵ These adjustments aim to address criticisms of debt dependency and environmental degradation. Approximately 57% of recent BRI projects now incorporate Environmental, Social, and Governance (ESG) safeguards.¹⁶

Global Experience regarding China’s Foreign Policy Strategy

China’s foreign policy under President Xi Jinping integrates economic diplomacy with strategic objectives. The BRI serves as a tool for expanding China’s global influence while addressing domestic economic needs such as surplus industrial capacity utilization.¹⁷ However, China’s assertive approach has often alienated partner countries.

Lessons for Nepal

- Negotiate terms that prioritize national interests over short-term gains.
- Leverage China’s soft power initiatives like “small yet smart” projects for broader benefits beyond infrastructure development.
- Negotiate terms that align with national interests while avoiding overdependence on Chinese loans.
- Focus on technology transfer provisions to enhance local capacity.
- Ensure alignment with long-term development goals rather than short-term gains.

5. Recommendations

To maximize the benefits of BRI while safeguarding Nepal’s interests, the government must adopt a strategic and balanced approach. The following recommendations can guide Nepal in navigating its partnership with China under the BRI framework:

Understand Chinese Interests: Nepal should gain a comprehensive understanding of China’s strategic and economic goals through the BRI. This knowledge will help ensure that Nepal’s own objectives align with China’s initiatives while maintaining national priorities.

¹⁵ <https://greenfdc.org/china-belt-and-road-initiative-bri-investment-report-2023/>

¹⁶ <https://www.aspistrategist.org.au/china-sharpens-the-bri-with-better-risk-management-esg-focus/>

¹⁷ <https://www.cfr.org/backgroundunder/chinas-massive-belt-and-road-initiative>

Form High-Level Committee for BRI Coordination: Nepal should establish a high-level committee involving key ministries and stakeholders to oversee the overall direction and implementation of BRI projects. This committee would ensure alignment with national priorities and effective decision-making.

Prioritize feasible projects: Nepal should focus on projects that are economically viable and can deliver clear, tangible benefits. Feasibility studies with thorough cost-benefit analyses should be conducted to ensure the projects selected have long-term economic potential and align with Nepal's development needs.

Diversify Funding Sources: To reduce over-reliance on Chinese loans, Nepal should seek multilateral partnerships and explore a broader range of financing options. Engaging with international financial institutions can provide more balanced and sustainable funding sources, reducing debt risks associated with Chinese loans.

Strengthen Negotiation Capacity: Nepal should establish a dedicated BRI coordination office with technical expertise in infrastructure financing and international negotiations. This will enable the country to effectively assert its interests, conduct thorough feasibility studies, and incorporate environmental and debt sustainability assessments into project evaluations.

Enhance Transparency: Ensure that all agreements related to the BRI are subject to parliamentary oversight to build public trust. The Memorandum of Understanding (MoU) and the Implementation Plan should be made public and open for parliamentary debate and stakeholder consultations to ensure transparency and accountability.

Maintain Competitive Bidding Processes: All BRI-related projects should undergo competitive bidding through global tenders to ensure fairness and value for money. This will foster a more transparent and open procurement system, encouraging local and international firms to participate.

Balance Regional Relations: While engaging with China and India, Nepal should build trusted relations and maintain strategic neutrality. Building mutual trust with both neighbors is crucial for Nepal's geopolitical stability and ensures that its engagement with China does not negatively impact its relationships with other key regional players.

The International Relations and Tourism Committee can play a critical role by:

- Facilitating national consensus on BRI priorities to ensure unified national positions during negotiations.
- Reviewing all agreements for alignment with long-term national interests.
- Establishing mechanisms for monitoring project implementation to ensure accountability and transparency. Strengthen institutional capacity by establishing technical committees for project evaluation and monitoring.

- Advocating for small-scale pilot projects to assess feasibility before committing to large-scale initiatives.
- Promoting public discourse on BRI-related issues to address concerns about sovereignty, debt sustainability, and environmental impacts.

By adopting these measures, Nepal can maximize the benefits of its partnership with China while safeguarding its economic sovereignty and geopolitical stability.

