

INDIA-NEPAL RELATIONS: REVIVING THE ECONOMIC TIES AMIDST CHINA'S GROWING INFLUENCE

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The ascendancy of Sher Bahadur Deuba to Prime Ministership is an opportunity for India and Nepal to rethink their flailing ties and strengthen both economic and strategic cooperation, vis-à-vis China. India and Nepal share long-standing economic and trade relations. India is Nepal's largest export market, as well as the most significant source of import. However, India faces stiff competition in its ties with Nepal, from China which has made inroads into both, its political and economic fabric. The article seeks to look at the key points of engagement in the economic relations between India and Nepal and suggest ways to improve cooperation, keeping in mind China's influence in the region.

Nepal's geostrategic location is sandwiched between the cold peace of its neighbours, India and China. Nepal prides itself in being a nation that has never been colonised, and has historically followed a diversified foreign policy, taking full advantage of its geostrategic location.¹ During the Cold War, for instance, Nepal

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1. Anil Sigdel, "China's growing footprint in Nepal: Challenges and Opportunities for India", Observer Research Foundation, October 3, 2018, at https://www.orfonline.org/research/chinas-growing-footprint-in-nepal-challenges-and-opportunities-for-india/#_edn8. Accessed on August 2, 2020.

accepted aid and assistance from both, the US and Soviet blocs. It focused on a strategy of non-alignment to benefit economically from both sides, much like post-independence India. Thus, given the power asymmetry that Nepal finds itself in today, between India and China, it should be no surprise that it would try to extract maximum gains by playing both sides. Nepal has also been a theatre of economic activity for both India and China, which seek to gain diplomatic leverage with their investments. It is interesting to note that, although Nepal-India ties are historically stronger, China has been able to make quick incursions and initiate several projects in Nepal. The total amount of foreign investment in Nepal, however, is still favourable to India.

HISTORY OF ECONOMIC COOPERATION BETWEEN INDIA AND NEPAL

Historically, provisions of the 1950 Indo-Nepal Peace and Friendship Treaty formed the basis of future economic cooperation.² The outline of the envisaged economic relations can be seen in Articles 2, 5 and 7 of the Treaty. Article 7 states, "The Governments of India and Nepal agree to grant, on reciprocal basis, to the nationals of one country in the territories of the other, the same privileges in the matter of residence, ownership of property, participation in trade and commerce, movement and other privileges of a similar nature."³ Article 5 grants the Government of Nepal transit rights in terms of import from or through India, of both, commercial products and arms and ammunition.⁴ Article 2 allays any security concerns by enabling the two countries to inform each other in case of "any serious friction or misunderstanding with any neighbouring State."⁵

The provision in the treaty for National Treatment has resulted in significant employment opportunities for Nepalese citizens. It is being estimated that approximately 6 million

2. Ibid.

3. "Treaty of Peace and Friendship between the Government of India and the Government of Nepal", Ministry of External Affairs, Government of India, July 31, 1950, at <http://mea.gov.in/bilateraldocuments.htm?dtl/6295/.Treaty+of+Peace+and+Friendship>. Accessed on September 4, 2020.

4. Ibid.

5. Ibid.

people from Nepal are working in India.⁶ Unsurprisingly, the presence of such a large number of people from Nepal in India has resulted in significant remittances to Nepal, thus benefiting the Nepalese economy.

Despite being a seminal document governing relations between the two countries, the Peace and Friendship Treaty of 1950 is no longer found to be acceptable to the Nepalese political leadership because it feels the treaty is outdated, out of sync with modern times and covers very few economic matters, and thus needs to be redone.⁷ To correct the points of discontent in the treaty, an Eminent Person's Group (EPG) was formed by the two governments in 2014. However, the proposals are yet to be accepted and there is a lack of clarity in the overarching nature of friendship between the two countries.

Subsequently, trade relations between India and Nepal have been governed by bilateral treaties of Trade and Transit and Agreement for Cooperation to Control Unauthorised Trade signed in 1971, 1978, 2002, 2009 and 2016.⁸ Tariff concessions form a crucial part of economic trade and are offered on both primary as well as manufactured products.

Currently, Nepal still relies on India for a major part of its trade. India is the largest trading partner of Nepal. Apart from this, 98 per cent of Nepal's transit trade takes place through India and 65 per cent of Nepal's total trade is with India.⁹ So, there is a lot of dependency on India, as far as Nepal's economy is concerned. India in recognition of its long-standing ties with Nepal, has increased its share in financial aid to Nepal by 73 per cent from Rs. 375 crores in 2017-2018 to Rs. 650 crores for the year 2018-2019. Nepal's share

6. "India-Nepal Relations", Ministry of External Affairs, Government of India, February 2017, at http://www.mea.gov.in/Portal/ForeignRelation/India_Nepal_Relations_11_04_2017.pdf. Accessed on July 7, 2020.

7. A. K. Bhatt and Narendra Kumar, "Resetting India-Nepal relations to offset Chinese threats", *The Daily Guardian*, November 24, 2020, at <https://theguardian.com/resetting-india-nepal-relations-needed-to-offset-chinese-threats/>. Accessed on July 1, 2021.

8. Nisha Taneja, Subhanil Chowdhury and Shravani Prakash, "India-Nepal Economic Cooperation: Towards a New Paradigm", *India Quarterly* 67(2), Indian Council of World Affairs and Sage Publications, 2011.

9. Riya Sinha, "The Road from India to Nepal: Development assistance and connectivity projects", The Brookings Institution, April 15, 2020, at <https://www.brookings.edu/2020/04/15/the-road-from-india-to-nepal/>. Accessed on September 3, 2020.

in India's total financial aid was 12 per cent in 2017-2018, which stepped up to 18 per cent in 2018-2019.¹⁰

SECTORS OF INDIAN ECONOMIC ASSISTANCE

Nepal was the first recipient of India's development assistance in 1951 and, soon after, 75 developmental projects were initiated under the Indian Aid Mission. It was renamed the India Cooperation Mission in 1966. India's objective with its aid programme was to supplement the efforts of the local government in sectors like education, health and infrastructure. India has been actively involved in Small Development Projects which focus on infrastructure and capacity building in areas of education, health and community development and are implemented by local bodies in Nepal.

In terms of *connectivity and infrastructure* projects, one of the largest and pioneering connectivity projects undertaken by India was the Tribhuvan Rajpath. It involved the construction of a 116-km-long highway and was initiated in 1953, and completed in three years.

In the *telecommunications* sector, India provided assistance for laying of the 904 km of Optical Fibre cable along the East-West Highway. For connectivity, India had helped in building and upgrading roads from highways to local rural constructions. It has also been involved with construction of roads along the swampy Terai region of Nepal. Electrification, flood control and drinking water projects have also been undertaken by India even in remote villages in Nepal. As far as *cross-border projects* are concerned, Government of India has committed to provide assistance to Government of Nepal for the establishment of Integrated Check-Posts (ICPs) at four major points along the India-Nepal border.

In terms of training and capacity development, several officers from the Nepalese army are sent to Indian military academies and combat colleges for training. Interpersonal ties between the two armies are also strong due to long established traditions between them. For example, the Indian army has seven Gurkha regiments today, with their individual battalions. Further, the Chief of the

10. Hari Bansh Jha, "Chinese Investments in Nepal in the context of BRI", Vivekananda International Foundation, October 11, 2019, at <https://www.vifindia.org/article/2019/october/11/chinese-investments-in-nepal-in-the-context-of-bri>. Accessed on January 3, 2021.

Indian army is decorated as an honorary Chief of the Nepalese Army and vice-versa.¹¹

Although India does not have a dedicated Humanitarian Assistance and Disaster Relief (HADR) policy, it has often used humanitarian assistance as a means to deepen its bilateral relations in its neighbourhood.¹² This has also been the case with Nepal with respect to flood and earthquake assistance. An interesting aspect about India's HADR involvement is the role of state governments and civil society groups in providing assistance. For example, during the 2015 earthquake in Nepal, religion-based organisations like the Rashtriya Swayamsevak Sangh and bordering states like Uttar Pradesh and Bihar were actively involved in disaster relief operations. This is testament to the proximity of the two countries in terms of their cultural and social connect.

India is also trying to build greater connectivity networks with Nepal, through multilateral projects. With the failure of the SAARC platform for cooperation, regional initiatives like the Bangladesh-Bhutan-India-Nepal (BBIN) corridor and the Bay of Bengal Initiative for Multi-Sectoral Cooperation (BIMSTEC), have taken precedence. Both these forums do not include China and Pakistan and are thus free of the political trappings of SAARC. The BBIN Motor Vehicles Agreement (MVA), for instance, is an initiative to ensure unhindered movement of vehicles between the member countries. It also makes it easier for land-locked countries like Nepal to access the Bay of Bengal ports. A BIMSTEC developmental fund has also been floated to account for the infrastructural needs of the region. The evolution of regional frameworks is a testament to growing economic confidence among member countries and must be realised to their full potential.

THE CHINA-NEPAL ECONOMIC ENGAGEMENT

In ancient times, economic diplomacy started off as local trade between Tibet and Kathmandu. The first agreement on economic cooperation was

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11. Claudia Meier and C. S. R. Murthy, "India's Growing Involvement in Humanitarian Assistance", March 2011, at https://www.gppi.net/media/meier-murthy_2011_india-growing-involvement-humanitarian-assistance_gppi.pdf. Accessed on August 13, 2021.
 12. Arjun Katoch, "A Review of Indian Participation in International Disaster Response", *Delhi Policy Group (DPG) Policy Note*, November 14, 2017, vol. II, issue 8, p. 2, at https://www.delhipolicygroup.org/uploads_dpg/publication_file/dpg-policy-note-vol-ii-issue-8-a-review-ofindian-participation-in-international-disaster-response-1070.pdf. Accessed on August 13, 2021.

the *1956 Agreement on Economic Aid*. An Inter-Governmental Economic and Trade Committee (IGETC) was established in 1982 to facilitate trade and investments, and became a forum for discussions on economic and technical cooperation. The Nepal-China Chamber of Commerce and Industry (NCCCI) founded in 1999, also promotes engagement between companies and entrepreneurs from the two countries.

One of the major turning points in India's relationship with Nepal, and a key inroad for China, was the 2015 blockade on the Madhesi issue. This ensured that relations took a turn for the worst, and the biggest beneficiary, as a result of ensuing tensions, was China. China, on the other hand, was able to use this situation to build closer ties with Nepal and parade as an all-weather partner. Here, New Delhi objected to Nepal's new constitution for allegedly discriminating against the Madhesi ethnic people who have close ties to India. India imposed an unofficial blockade on imports of fuel and essential supplies at a time when Nepal was already reeling from the after-effects of a recent earthquake. China, on the other hand, was quick to step in with emergency oil supplies. The demonetisation exercise further dented relations between the two countries as Nepal relies greatly on remittances from expatriate workers in India.

The inroads made by China was used to aggressively push the Belt and Road Initiative into Nepal. The BRI is China's Marshall Plan in the region and was initiated in 2013. It involves a combination of a 'belt' of overland corridors and 'road' of maritime shipping lanes. Apart from being an economic corridor, it is also seen as a strategic tool since the ports and transport infrastructure being built could be utilised for both commercial and military purposes.

The creation of the Chinese International Development Agency (CIDCA) in 2018 under the broader BRI framework, has given a further impetus to development assistance in Nepal. As of March 2019, the CIDCA has offered to take care of the infrastructural needs of the northern districts of Nepal, which border Tibet Autonomous Region. This also works to undercut the influence of Tibet which has been supplying food aid and other essentials to this region. Chinese aid includes direct development support to local bodies in the 15 districts in Northern Nepal to promote health, infrastructure and education in these districts. China's foray into livelihood missions include the development of three

North-South corridors in Nepal, namely, Koshi Economic Corridor, Gandaki Economic Corridor and Karnali Economic Corridor in order to create jobs and improve local livelihood, and stimulate economic growth and development. Further, the upgradation of the technical skill set of those working on rail, road, tunnel engineering and shipping projects, has also been promised by the Chinese. China has gone on to make investments in connectivity that go beyond railways and transport. In 2018, a fibre optics link was inaugurated and Huawei also concluded a deal to develop a 4G network.

Involvement in the BRI was considered important for Nepali policymakers as it appeared to provide innumerable opportunities to sharpen its domestic infrastructure. The two sides have already concluded trade and transit agreements, and Nepal is eyeing connections with the Chinese market and oil refineries as well as the global supply chain via Chinese ports.

The overall economic framework for the projects undertaken in Nepal has been institutionalised with the Nepal-China Joint Commission on Economy and Trade. Under its aegis, Nepal and China will establish a working group on investment cooperation and another on trade, headed by top officials, in order to boost trade and investment.

In terms of investments in the energy sector, China has been involved in several hydropower projects. Nepal lacks the capital and technology to build large dams and other water projects and also needs a buyer for its hydropower. As of last year, Nepal's Hydroelectricity Investment and Development Company Ltd. (HIDCL) and Power China have entered a joint venture to build two hydropower projects in Nepal.¹³

China does not enjoy historical and people-to-people contacts with Nepal on the same level that India does. However, it is no stranger to deploying long-term economic and infrastructural aid. The Chinese design in Nepal includes scaling up its road and network connectivity projects including a railway line between Tibet and Kathmandu, which looks to have geopolitical and geo-economic implications for

13. Joint Statement between Nepal and the People's Republic of China, at <https://mofa.gov.np/joint-statement-between-nepal-and-the-peoples-republic-of-china-2/>. Accessed on June 3, 2020.

India. China has also proposed several multilateral frameworks, such as the Trans-Himalayan Developmental Cooperative Framework, which places Nepal in the centre stage. Despite China's push towards greater connectivity, it still needs to overcome certain challenges posed by geography. For instance, the economic viability of such projects is contingent on tapping into the Indian market. Further, the connectivity projects traverse the Terai region, whose inhabitants have close cultural ties with India.

THE WAY AHEAD IN INDIA-NEPAL RELATIONS

The COVID pandemic has painted a gloomy picture to the world economy as it has led to supply, demand and financial shocks from extensive lockdowns and distancing measures. The effect of the pandemic is slated to drive more than 49 million individuals into extreme poverty due to job losses and lack of access to basic resources.¹⁴ The issue is more acute in South Asia due to the large and dense population, weak social protection systems and high poverty rates.¹⁵ As India inches towards recovery, it is important for it to strengthen its outreach to its neighbours to ensure a swift and collective economic resurgence.

Nepal's economic ties with India need to be focused because of the looming post-COVID scenario. The envisioned growth rate of 8 per cent for 2021 looks highly unlikely. The widening fiscal deficit could look to expand even further with the government having to spend more to bail out troubled sectors. It could also mean greater overseas borrowing, thus increasing its debt burden. Post the 2015 earthquake in Nepal, the Himalayan country had seen a new robustness to its economy, with an increase in reconstruction aid, high electricity production, and an increase in big infrastructure projects. However, this pace is set to slow down, due to a loss in revenue via remittances from Nepalis working abroad and a slowdown in the tourism sector.

14. Golam Rasul et al., "Socio-economic Implications of COVID-19 Pandemic in South Asia: Emerging Risks and Growing Challenges", *Frontiers in Sociology*, US National Library of Medicine, February 24, 2021, at <https://www.ncbi.nlm.nih.gov/pmc/articles/PMC8022444/>. Accessed on June 29, 2021.

15. Arti Yadav et al., "Socio-economic scenario of South Asia: An Overview of Impacts of COVID-19", *South Asian Survey* 28, no. 1, pp. 20-37, February 23, 2021, at <https://journals.sagepub.com/doi/10.1177/0971523121994441>. Accessed on June 29, 2021.

This may be an opportunity for its neighbours like India and China to expand support to Nepal.

One of the key areas for future engagement would be cooperation in the *power sector*. This would involve building cross-border transmission lines, allowing greater access for Nepal-based power producers to the Indian market and even developing an integrated grid. Further, although hydropower cooperation has historically been a key point of engagement, timely *project completion* is important for the Indian government as China has simultaneously been able to make inroads into the hydropower sector in Nepal. Apart from the hydropower sector, India has signed ambitious MoUs in the transport sector with Nepal. For example, MoUs for building the Raxaul-Kathmandu broad gauge railway link and agreements in principle to allow Nepal to use three inland waterways (Kolkata-Kalughat, Raxaul; Kolkata-Sahebgunj; Kolkata-Varanasi-Raxaul) have been decided but need to be implemented in a phased, comprehensive and time-bound manner.

For Nepal, its *trade deficit* with India has been a major point of concern. Among the factors responsible for this are the lack of competitiveness of Nepali goods in the Indian market, administrative hassles and large amount of unauthorised trade via open borders.¹⁶ Options that can be explored to remedy the situation include increasing value addition capacity to products being exported from Nepal, prioritising goods with competitive advantage, such as shawls, handicrafts and carpets which are labour-intensive products, among others.

India's trademark *skill development* projects in Nepal can also be made more robust with the changing times. Training in new age skills like Artificial Intelligence and robotics can provide an important skill set to the youth to tackle the challenges of future jobs. Engaging *multilateral platforms* devoid of the China factor, such as BIMSTEC is also key to progress relations. The feasibility of a BIMSTEC FTA must be undertaken in order to provide optimal trade opportunities in the region.

16. Manish Jung Pulami, "Nepal's increasing Trade Deficit with India and Bangladesh", *The Kootneeti*, June 7, 2020, at <https://thekootneeti.in/2020/06/07/nepals-increasing-trade-deficit-with-india-and-bangladesh/>. Accessed on December 5, 2020.

CHINA'S ENGAGEMENT AND CHALLENGES FOR INDIA? TACKLING THE CHINESE CHALLENGE

One of India's concerns is likely to manage *China's influence* in Nepal. The year 2019-2020 has been a difficult time in the neighbourhood for India. According to External Affairs Minister, S. Jaishankar, India-China ties are currently in the most difficult phase in the last 30-40 years.¹⁷ Neighbours like Nepal are caught in the quagmire with constant flare-ups concerning one or the other country. On the Nepalese side, relations have witnessed a pro-China tilt with Nepal publishing its map incorporating 300 square kilometres of Indian territory. Between India and China itself, the Ladakh stand-off seeks to endanger not only political but also economic ties. However, amidst the diplomatic pressures long-term engagement must not be forgotten. Economic relationships between countries affect the common man, and he/she stands to lose the most from an inward-looking or isolated neighbourhood.

Although China and India's areas of assistance and investment are very similar in Nepal, India enjoys the advantage of longer and more sustained cooperation over decades. India has often been perceived negatively as a 'Big Brother' to Nepal due to its close involvement in Nepali politics, especially after 2015. India's geographical size and importance in the world as one of the fastest growing economies, relative to Nepal, does not make the situation easier. Dispelling this image by invigorating unique cultural, ethnic and historical ties and strengthening India's grassroots-based development programmes is key to improving ties with Nepal and restraining the pro-China tilt. India, thus, looks to fight a battle on two fronts, against China, one of competitiveness of economic assistance, and the other of dispelling perceptions. China's aid-giving practices often give off the perception of a horizontal partnership and equal power dynamic, but in actuality come with unmistakable geopolitical ambitions. India's 'Neighbourhood First' policy must thus prioritise one of its key pillars, in the coming months: finding economic complementarities with Nepal and strengthening them.

17. The Economic Times Bureau, "India-China Relationship Profoundly Disturbed", December 9, 2020, at <https://economictimes.indiatimes.com/news/politics-and-nation/india-china-relationship-profoundly-disturbed-most-difficult-phase-in-last-30-40-years-s-jaishankar/videoshow/79643875.cms?from=mdr>. Accessed on June 7, 2020.