

SHIFTING ALLIANCES IN SOUTH ASIA: EXAMINING CHINA'S ECONOMIC IMPACT ON INDO-NEPAL RELATIONS

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INTRODUCTION

The rise of China's economic activities in South Asia, including the BRI, has altered the geopolitical dynamics of this region. Within the context of the development of the region and the introduction of Chinese investments, Nepal, which historically belonged to the sphere of influence of India, is facing subtle changes. This shift is particularly retrospective because it impacts the relationship between India and Nepal and suggests forward changes in the status of alliances in the South Asian region. Chinese engagement in Nepal consists of infrastructural developments, coupled with foreign aid, which are two elements that have changed and redefined Nepal's dependencies and international relations strategies. Especially a

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desire to benefit from Chinese economic assistance by rebuilding the infrastructure and generating electricity encourages the country to join the BRI.¹ This deepening economic relationship with China provides Nepal with critical financial and technical support to complement its developing economic posture.² On the contrary, India has continued to play a predominant role in Nepal, which has historically dominated the relationship's inclusion of culture, politics, and economy.

This paper explores the dynamic shifts in Indo-Nepal relations prompted by China's increasing economic involvement in Nepal through the Belt and Road Initiative (BRI). It reveals that Nepal's growing economic dependence on China has led to a strategic pivot towards Beijing, diminishing India's historical influence in the region. By employing a mixed-methods analysis of trade, investment data, and diplomatic discourse, the findings indicate a significant realignment of regional alliances, urging India to adapt its policies in response to China's expanding geopolitical ambitions in South Asia.

This paper adds to the growing body of research focussed on the changing nature of alliances in South Asia by exploring the dynamic change in the trajectory of Indo-Nepal relations in the context of Chinese economic engagement. The findings that emerge from this study point out how India needs agilely tailored policy responses to maintain its share of influence in Nepal as Chinese influence surges ahead. To that end, this research paper will use a mixed-methods approach, combining some quantitative data about trade and investment with qualitative analysis of the diplomatic discourse to tease out the broader geopolitical implications of China's economic strategies in South Asia. This is because these sectors would help assess China's economic engagement and scrutinise its implications for Nepal's strategic autonomy and the nexus between Nepal and India. For instance, the case of its stance on the one-China policy and how it resolved its differing views on territorial and economic disputes with India over some of Nepal's territories, as well as

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1. J. Chen, and H. Wang, "Nepal's Alignment Dilemma In South Asia: India or China?" *Asian Economic Policy Review*, 9, no. 4, 2022, pp. 92-115.
 2. X. Liu, and W. Zhang, "Nepal's Belt And Road Dilemma: Economic Gains Versus Sovereignty Concerns," *Journal Of Contemporary Asia*, 51, no. 4, 2021, pp. 512-530.

Indian economic policies also affect this bilateral partnership between India and Nepal. Statistical tools would then be applied in order to evaluate changes in trade volumes, investment shares, and the financial impact of Chinese aid on Nepal's economy. Content analysis techniques contribute to the codification and classification of declarations made by officials from Nepal in order to draw inferences about the nature of Nepal's positioning with regard to India and China. The themes identified would include "economic cooperation," "sovereignty," and "strategic partnerships" in order to understand the changes in the priorities of Nepal's foreign policy.

India's influence seems to be increasingly encroached upon by Nepal's growing economic relationship with China. The inter-relationships between India and Nepal have been studied.³ This development poses a serious challenge for India, which is still reeling from the Chinese influence on the changing dynamics of geopolitics within the Asian subcontinent.⁴ In this respect, Vietnamese and Nepali relations, managed with the presence of China, have attracted appreciable attention. These studies argue that the competitive economy of China is now changing the diplomatic direction of Nepal, and mostly at the cost of India's position in the region. However, many argue that Nepal is turning to China due to *realpolitik*, in which Chinese funding is enabling more multi-sided development compared to Indian assistance, which is viewed as more restrictive.⁵ This is particularly so in strategic sectors like transportation and energy, where Chinese projects have seriously picked up pace.⁶ The

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3. S. Kumar, and R. Singh, "The Role Of India In Nepal's Economic Landscape," *South Asia Quarterly*, 15, no. 1, 2022, pp. 19-37; A. Sharma, and K. Basu, "Navigating Between Giants: Nepal's Foreign Policy In A Changing South Asia," *Strategic Analysis*, 45, no. 1, 2021, pp. 101-124.
 4. A. Basu, and P. Banerjee, "The Belt And Road Initiative In South Asia: A Double-Edged Sword For Nepal," *South Asia Journal of International Studies*, 11, no. 1, 2023, pp. 43-58.
 5. R. Adhikari, S. Sharma, and M. Thapa, "Strategic Investments In Nepal: Implications For Indo-China Relations," *Journal of South Asian Affairs*, 12, no. 2, 2023, pp. 144-165.
 6. L. Zhang, and Q. Liu, "The Evolution of Sino-Nepal Relations: A View From Economic Integration," *Journal of Contemporary Asian Research*, 9, no. 3, 2021, pp. 221-246; B. Pandey, and N. Thapa, "Trade Dynamics And Regional Stability In South Asia: The Case Of Nepal." *Asia-Pacific Economic Review*, 13, no. 3, 2021, pp. 243-267.

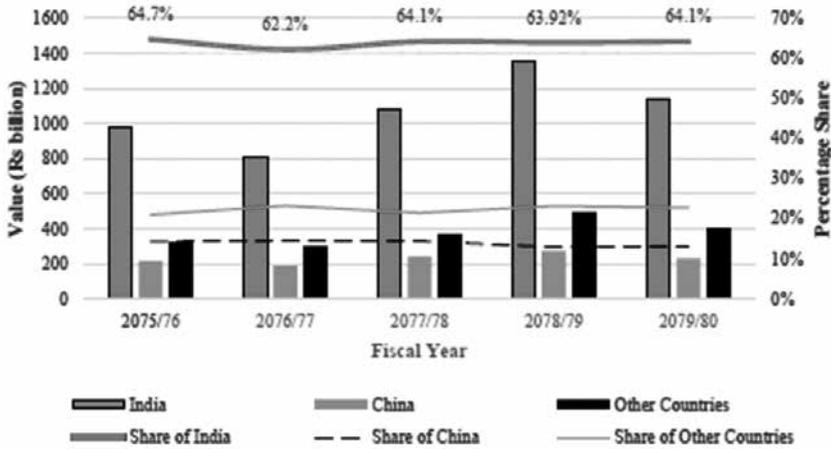
benefits this brings, in turn, have made Nepal seek other alternative trade partners that deviate from the traditional patronage it has always accorded India.⁷ However, Nepal's tilt towards China is not risk-free. Increasing economic dependence on Chinese investments might actually clip the wings of Nepal's policy autonomy, raising serious concerns about sovereignty and the future sustenance of such relations.⁸ Further, this alignment introduces complexities in the foreign policy of Nepal because there would be a strain between the two leading neighbours, and Nepal would need to balance the interests of both in its foreign policy.⁹

TRADE DYNAMICS: INDIA-NEPAL AND NEPAL-CHINA

The Fig 1 shows the trade data from 2018 onwards and it highlights India's dominance in Nepal's continued trade which accounts to almost 62 per cent of Nepal's total trade. India's consistent trade values underscore deep economic ties between India and Nepal. With respect to China's trade with Nepal, the figure only depicts a slight growth which is below 15 per cent as shown in the figure. It is important to note that while China has been expanding its presence through the Belt and Road Initiative, it still has to make an impact on Nepal in terms of economic trade. Additionally, despite the growing proximity between Nepal and China, Nepal's relations with India still remain consistent economically. China's presence and influence in Nepal are primarily strategic and not yet economic, which reflects that China's economic impact is not yet disruptive to Indo-Nepal trade. So, it is pertinent that India reinforces its presence and continues to be Nepal's primary economic partner which would challenge China's efforts to realign regional politics in South Asia through economic means. This highlights Nepal's growing strategic integration with China, while India maintains its strong historical trade ties and strong economic linkages.

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7. S. Choudhury, and N. Prasad, "Evaluating Nepal's Economic Strategy Amid Sino-Indian Rivalry," *International Journal of South Asian Studies*, 14, no. 1, 2022, pp. 67-80.
 8. A. Bhattarai, and R. Sharma, "Dependency Or Development? Assessing Nepal's Economic Engagement With China," *International Relations Review*, 15, no. 3, 2023, pp. 200-223.
 9. P. Joshi, and S. Poudel, "Nepal's Foreign Policy And The Influence of Chinese Investments," *Asian Geopolitics*, 8, no. 3, 2021, pp. 150-173.

Fig 1: Five-Year Trend of Nepal’s Total Foreign Trade

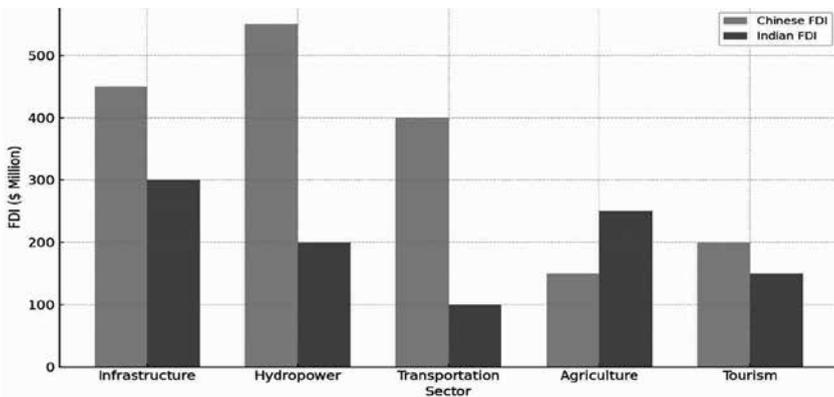


Source: The fiscal years mentioned in the figure are in the format that Nepal follows. Department of Customs, Ministry of Finance, Government of Nepal, 2022-2023, <https://customs.gov.np/storage/DoC/2080-81/Statistics/Annual%20Foreign%20Trade%20%20Statistics%20Book%202079-80.pdf>. Accessed on March 20, 2025.

China’s investments in Nepal have been concentrated mainly on infrastructure, hydropower, and the transport sector, with an aggregate worth of \$1.75 billion. India’s Foreign Direct Investment (FDI), on the other hand, is very much concentrated in the sectors of agriculture and tourism, sectors that are more automatically aligned with the historical ties of Nepal to India. Fig 2 illustrates the sector inequality between the two countries’ focus. China’s FDI disfavours other sectors in the country but is strong in the critical infrastructure sectors, which are highly strategic for Nepal, increasing Nepal’s dependence on China. Indian FDI is high in focus, yet it is mainly in less strategic sectors, depicting a different economic engagement policy. The figure compares Chinese and Indian FDI in key sectors in Nepal between 2020 and 2024. China leads significantly in infrastructure and the transportation sector, reflecting its focus on large-scale development projects, aligned with initiatives like the BRI. Hydropower also sees a major Chinese investment, overshadowing

India's contribution in this area. In contrast, India shows relatively higher investments in agriculture and is almost at par with China in tourism, indicating a focus on grassroots and people-centric sectors. The overall trend underscores China's dominance in capital-intensive projects and India's emphasis on socio-economic linkages.

Fig 2: Comparison of Chinese and Indian FDI in Key Sectors (2020-24)



Source: <https://www.china-briefing.com/news/chinas-fdi-trends-2024-key-sources-destinations-and-sectors/>. Accessed on November 24, 2024.

On the one hand, the themed discourse of the Nepalese diplomatic statements, where China has been mentioned, exhibits the issues of economic cooperation and interference. In contrast, with reference to India, the concerns primarily hover around regional stability and strategic autonomy. This shift casts a shadow on Nepal's desire to strike a balance with both states with its delicate diplomacy between China and India, as portrayed in Table 1. The table comes up with a comparative study of Nepal's diplomatic statements from 2021 to 2024 concerning its engagements with China and India on four issues: economic cooperation, strategic autonomy, non-interference, and regional stability. With hydroelectric and infrastructural cooperation in the lead, China dominated with its 30 references against India with only 20; this is a trend that depicts Nepal's growing dependence on Chinese investments, especially in infrastructural and connectivity

projects like the Belt and Road Initiative. Yet India also figures in the exercise as a very important economic partner, though its clout has been perceptively less dynamic in recent repeated references by Nepal. Another point of discussion has slipped into the plane of strategic autonomy, taking 25 seats in favour of India while China has grabbed only 15; this looks plausible because of Nepal’s past efforts to restore its sovereignty against India on account of the perceived asymmetry and interference for all these years. In contrast, non-interference with the comparison to India does become more vocal than it does with the comparison to China; this substantiates an argument wherein the realisation dawns that India tends to interfere in Nepal’s internal affairs while China is, at least on a pedestrian level, viewed as the least interventionist. The summit is finally assembled where the mention of regional stability tops the lists: South Asian politics for India at 30 and for China at 20. This would suggest that Nepal realises that India remains a central figure in South Asian politics and to ensure peace in the region, Nepal acknowledges this power even after much influence from China is observed. The table shows how delicately Nepal maintains the balance with its two strong neighbours.

Table 1: Thematic Coding of Diplomatic Statements from Nepal (2021-24)

S. No.	Theme	Mentions Regarding China	Mentions Regarding India
1.	Economic Cooperation	30	20
2.	Strategic Autonomy	15	25
3.	Non-Interference	10	15
4.	Regional Stability	20	30

Source: Compiled by the author from primary and secondary sources.

In recent years, there has been a radical change in Nepal in terms of economic and diplomatic dynamics as the increasingly aggressive presence of China, through strategic economic engagements, has worked its way into the heart of Nepal’s social fabric. This includes a phenomenal increase in trade volume from China and FDI into Nepal’s infrastructure and hydropower sectors. Furthermore, the

implications of this development run very deep into the geopolitical environment of South Asia and with it, the intricate Indo-Nepal relationship. It is hoped that in the course of the next five years, China might emerge as the one major economic partner for Nepal; however, the investments made should not deepen economic dependency between the two nations, but strategically bind Nepal closer to the wider ambitions of China. Chinese investments are especially focussed on infrastructural sectors, which are crucial to the economy in Nepal, but generate dependencies that might otherwise constrain Nepal's policy autonomy. Such power is part of the overall strategy of China within the BRI to consolidate its status as the core economic power within South Asia. This economic dependency on China may, thus, consolidate the neoclassical industrial policies, thereby making it a "power-seriously emerging" actor in Nepal's decision-making over foreign policy orientation.

On the other hand, India had raised about \$971 million in administrative investment in Nepal by the year 2012 and has concentrated in sectors that are less strategic, including agriculture and tourism. Such investments may be important, but they are infinitely less liable to transform the sector than Chinese investments in infrastructure. If so, this changing nature of investments could undermine the historical ties between India and Nepal, with increased peripheral influence of India on the issues of significant strategic and economic stakes. The change stands completely opposed as per the analysis, as shown in a comparative review of contrasting types of sector-based investments, showing that Nepal's development and strategic priorities are realigning more with Chinese interests than Indian. The thematic analysis of Nepal's diplomatic discourse further shows a subtle attempt at striking a balance between the two giant neighbours. While Nepal emphasises regional stability within its relations with India, its rhetoric on economic cooperation as well as non-interference with China has expanded dramatically. This is indicative of Nepal's strategic manoeuvring of balancing its relations between being maximally benefited in economics from its association with China while maintaining a cordial and historical connection with India. The rising economic dependence on China, however, creates potential vulnerabilities in ensuring a balance with it and

challenges Nepal's long-term strategic autonomy. Nevertheless, the thematic analysis gives a coarse representation of the diplomatic discourse, which shows subtle attempts at balancing between the two giant neighbours. While emphasising regional stability when dealing with India, the discursive rhetoric on economic cooperation and non-interference with China has expanded exponentially. This is an indication of Nepal's strategic calculations of balancing out relations in view of hindering maximally benefited economics with its growing association with China and yet keeping the cordial and historical connection intact with India. However, the growing economic dependence on China leads to vulnerability in balancing with China, and this might prove to be a challenge for Nepal in its longer-term strategic autonomy.

CHINA, NEPAL AND INDIA IN SOUTH ASIA

The growing China-Nepal relationship directly affects India's strategic interests in South Asia. Historically, the basis for India's special relationship with Nepal came from open borders, cultural ties, and economic interdependence. Yet, Chinese penetration has made India less capable and, thus, created a more competitive environment. This shift was exemplified when Nepal, in 2015, accused India of putting an unofficial embargo during the Nepal blockade; thus, Kathmandu reached out to Beijing in order to diversify its trade and transit routes.

India's challenge is to rescale the balancing act between its historical relationship with Nepal and the forecast Chinese growing footprints. It needs to redirect its engagements concerning an upgrade in economic cooperation, infrastructure development, and people-to-people ties. India also needs to remedy its poor political relations with Nepal, especially on some border disputes and interference in Nepal's internal affairs. If it does not do so, Indian influence in Nepal will decrease further and the regional balance will be tilted toward China. China's rise in interest in Nepal signifies a shifting regional landscape; India can no longer automatically expect to have special status as Nepal's closest partner. The resurgence of Chinese interest in Nepal, buoyed by significant investment activities and strategic diplomacy, has effectively made Kathmandu the locus of Sino-Indian

rivalry in South Asia. Such trends allow Nepal bargaining power with regard to regional diplomacy and complicate India's retention of influence over its northern neighbour. India needs to respond with a more subtle yet vigorous approach to counter the challenges posed by China's increasing footprint in Nepal, a challenge that would allow it to remain a relevant player in shaping the future of South Asian geopolitics.

Thus, the orientation of Nepal towards China is a crucial development for India, presenting a serious challenge. Traditionally, Nepal has acted as a buffer state that has helped to maintain the careful equilibrium between India and China. The increase in Chinese violence does not merely dilute India's influence over Nepal; it creates huge security and geopolitical dilemmas for India in a strategically sensitive region. Evidently, India will need to reappraise its approach toward Nepal to make its engagement a little more consistent with Nepal's changing development needs and strategic priorities if India is to keep the upper hand in the engagement to further augment its influence. The change of allegiance on the part of Nepal may serve as a touchstone for testing the broader regional dynamics, and some of the other countries in South Asia are expected to redefine their foreign policies in the light of the shifts resulting from China's increased influence. This could essentially crystallise a realignment of the regional order and put India in a proper position to adapt to its adjusted role and maintain its influence in the region. Hence, there is a need for the South Asian powers to redefine some of their regional policies consciously. For India, there needs to be an articulation, and acceptance, of a more sensitive and strategic framework to engage Nepal, as a counter-balance against the ever-deepening Chinese influence and an environment conducive to furthering mutual growth and stability in South Asia.

CHINA-NEPAL PARTNERSHIP AND SOUTH ASIAN GEOPOLITICS

With increasingly closer ties between China and Nepal, a new geopolitical contour is being defined for South Asia. China is dealing out economic investments, strategic outreach, and political engagement with Nepal; this trend has not only disturbed the

degrees of power already existing, adding dimensions to this region's dynamics but also has caused a monstrous upheaval among the power structures, alliances, and the level of diplomatic engagement within South Asia itself. China's strategic interest in Nepal is primarily driven by the BRI plans, which envision Nepal as a critical link connecting South Asia with China. The ambitious Trans-Himalayan Multi-dimensional Connectivity Network, including plans for a railway line connecting Kathmandu to Tibet, highlights Beijing's commitment to reducing Nepal's economic and transit dependency on India.¹⁰ These infrastructure projects not only provide Nepal with alternative trade routes but also strengthen China's presence in South Asia, challenging India's traditional dominance in the region. By integrating Nepal into its economic orbit, China is effectively extending its sphere of influence into India's backyard, altering the regional power dynamics.

Alongside growing alignments with China, Nepal's standing in the regional diplomatic space has strengthened its position of negotiation between its two powerful neighbors.

For now, this has provided Nepal with a degree of freedom regarding its foreign policy, albeit while sometimes persisting in challenging the hold India has always enjoyed. For example, while many attribute the 2015 economic blockade to pressures from India, it was, ironically, Nepal that turned to China for support, enhancing the ties between the two nations. A proverbial turning point in Nepalese foreign policy, this had not only yet again shifted its dependency away from India but also proved to be strategically rewarding in assuring the relevance of its partnership with Beijing. As the other smaller nations in South Asia—Bhutan, Bangladesh, and Sri Lanka—watched Nepal's relationship with China blooming, they took it as a possible mechanism for bringing in the balanced approach to contain the influence of India while tapping on the Chinese investments for their domestic growth. This rising stature of China in Nepal has furthered the competition layer in South Asia. Nepal is now an area

10. Nikhil Sahu, "Nepal's Trans-Himalayan Dream: A Journey Through High Costs and Higher Stakes," Vivekananda International Foundation, 2022, <https://www.vifindia.org/2024/september/09/Nepal-s-Trans-Himalayan-Dream-A-Journey-Through-High-Costs-and-Higher-Stakes>. Accessed on November 25, 2024.

India considers as falling within its sphere of influence, where India finds it difficult to retain its strategic and economic edge. Open borders and cultural relations dating back to a historical timeframe have for long formed the base of the bilateral relationship between India and Nepal. However, with the entry of China, Nepal has just that much more room for alternatives that, thus, have diluted India's erstwhile privileged status. However, this is not just an investment war; it spills over into the areas of security and diplomacy. China's admission of the "One China" principle has given Nepal an opportunity to prioritise its policies to suit Beijing's strategic preferences, as in curtailing the activities of the Tibetan refugees.

With the tangible intensification of the China-Nepal partnership leading to realignment theories of South Asian geopolitics, other parties are being drawn in and getting polarised, and the differences between the drifting ideologies has become more evident. Whereas some countries are on an unequivocal pro-China line, like Pakistan, which has been very open to Chinese investments through projects like the China-Pakistan Economic Cooperation (CPEC), others, including India, are getting anxious about what China is planning. The sharpening Sino-Indian rivalry is becoming visible, not only in Nepal but across the wider South Asia region, as China's economic initiatives generally come with a superimposition of geopolitical aspirations. The likely outcome is a narrative for deepened fissiparousness amongst the South Asians as countries begin international alignments that follow their economic and geopolitical interests and are counter-productive to regional unifying forces.

The rapid crystallisation of relations between China and Nepal constitutes the emerging factors that redefine South Asian geopolitics. Enhancement of China's influence in Nepal has added a new axis of power to the region; put a rougher hand on the pulsating dominance of India, and, thus, demanded strategic amendments. This coming revolution in shaping alliances is affording a changing tilt within the new realms of South Asian geoeconomics and politics.

CONCLUSION

China has seriously stepped up its economic engagement in Nepal and realigned the regional partnership nexus across South Asia

through the BRI. This signals an important shift in regional power balances, indicating that Chinese strategic infrastructure and trade investment have massively undercut Indian historical influence over Nepal. It is an arduous journey for India, which already faces stiff competition in its traditional sphere of influence amid the deepening economic clout of China. The findings of the research point toward Nepal's strategic pivot toward Beijing due to its rising engagement on the economic front as an endeavour to diversify and enhance on the diplomatic front and gain further strategic autonomy. Nevertheless, such a shift to China plays out in a complicated manner in Nepal's international relations, as it has to manoeuvre through the competing interests of two fierce regional powers. Nepal envisages China as an irreplaceable actor in its infrastructure and economic development, therefore, making China potentially an irreplaceable player in Nepal's future development path. The developments should rouse India to the strategic necessity of reassessing its relations with Nepal, with the time having come for deeper and more potent policy options than mere diplomatic ties, which are left exposed to changing geopolitical stream requirements. This would imply an alignment between the size and scope of Chinese investments with elevating cooperation on areas vital to Nepal's national interests, including technological transfers, education, and sustainable development. However, much more importantly, the greater regional importance of this realignment of Nepal does raise some serious apprehensions about the regional stability of South Asia. The emerging dynamics hint toward the possibility of a trend wherein some neighbouring states renormalise their alliances and foreign policy trajectories in the wake of the assertive regional policies pursued by China.

This demands that India adopt a much more proactive and flexible stance, aligned with regional strategy, to advocate a very balanced and multilateral regional order, underscoring the intensified Chinese presence, while ensuring safe-guarding of its worthy interests. In this regard, China's economic strategy for Nepal, focussed on building up trade relationships and infrastructure investments, bespeaks a turning point in South Asian regional politics. This study underlines the fact that India needs to think innovatively in its diplomatic-economics ethos to effectively match the ever-shifting geopolitical

realities. Therefore, India must announce a clear and concise policy design that will ensure mutually beneficial growth and stability in the region, and also accord relationships with Nepal and other neighbours a new life vis-à-vis the challenges of gradual multipolarity.