

A New Infrastructure Diplomacy in South Asia

Implications and Options for Nepal and other South Asian Recipient Countries

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Introduction

South Asia has become one of the world's fastest growing regions, and with its member countries' developing economies comes increased demand for better physical infrastructures. While the increased size of the economies of South Asian countries has enabled its governments to mobilize domestic capital to fund large infrastructure projects, this capital is still inadequate to meet the region's needs. South Asia has undergone rapid transformation since the end of the Cold War, as India quickly industrialized to become South Asia's economic leader. In recent decades, countries like Pakistan, Nepal, Bangladesh, and Sri Lanka are looking to follow in India's direction. At the heart of this change is brewing geopolitical competition among large donor countries that are looking to expand their influence in the region through aid and infrastructure investments. This presents both opportunities and unique sets of challenges for recipient countries.

China is currently the largest donor to South Asia, having committed at least \$100 billion to infrastructure

projects in the region since the announcement of its ambitious Belt and Road Initiative (BRI) in 2013.¹ It has funded some of South Asia's largest infrastructure projects, including Sri Lanka's Hambantota Port, Pakistan's Gwadar Port, and a strategic bridge over Bangladesh's Padma River, which connects the country's north and south regions through highways and railways. In Nepal, China has invested in developing hydropower projects and airports while highways and railways are being planned under the BRI initiative. But China is not the only donor that wants to expand its influence in the region. The United States, along with its allies like France, Germany, the United Kingdom and Japan, have also been investing heavily in the region. This is indicated by the fact that the annual investments made in South Asia by the U.S. and its Development Assistance Committees (DAC) allies have significantly increased over the past decade. India has also boosted its aid budget to its South Asia neighbors, allocating USD 2.5 billion dollars for its external affairs in 2021. At least 71 percent of its foreign aid spending is allocated for South Asian neighbors like Bhutan, Nepal, Maldives, and Bangladesh.²

1 Committee on Foreign Affairs. "China Regional Snapshot: South Asia," March 16, 2021. <https://bit.ly/3Qsvig3>.

2 Laskar, R. H. "India Allots over 7,000 Cr as Foreign Aid, Commits 100 Cr to Chabahar Port." Hindustan Times, February 1, 2021. <https://bit.ly/3Daz1vO>.

South Asia has a land route that can connect China's huge market to Central Asia and Europe. This explains Beijing's ambitious investments in infrastructure and connectivity in the region, particularly for the China Pakistan Economic Corridor (CPEC), which is one of its most important BRI projects. DAC countries, led by the U.S., have also extended their aid and investments by extending support to regional connectivity initiatives, like the South Asia Subregional Economic Cooperation (SASEC). The U.S. in particular has also been providing bilateral grant aid in infrastructure projects through the Millennium Challenge Compact (MCC) and has more recently been leading the G7 initiative Build Back Better World (B3W) in response to China's growing influence in the region.³

This policy brief will draw from PEI's ongoing research and the available literature to assess these aforementioned trends in infrastructure aid diplomacy in South Asia and what it means for recipient countries. It is not an exhaustive study but simply an attempt to understand the motivations of the donor countries making large infrastructure investments in the region as well as the strategic interests of recipient countries.

Global Politics and South Asia

South Asia constitutes roughly one quarter of the global population. It is home to 1.83 billion people living in eight countries that account for a combined gross domestic product (GDP) of USD 3.59 trillion.⁴ The region is growing fast, but its growth is undermined by endemic poverty and a large infrastructure gap.⁵ Before 1950, most parts of the region were directly or indirectly colonized by the U.K., which is blamed

for a loss in resources, broken institutions, and 'poor long-run development outcomes' in the region.⁶ Even after decolonization, the partition of India and Pakistan in 1947 and Pakistan and Bangladesh in 1971 resulted in widespread ethnic violence, migration and incidences of war that continue to affect their bilateral relations today. Further, South Asia's unresolved border issues have made it politically volatile and one of the least integrated regions economically, hindering connectivity and growth.⁷

However, most countries in the region have transitioned from decades of conflict and instability in the recent years and are aspiring to achieve economic growth and global connectivity. India in particular has been impressive in expanding its growth over the past three decades. Being geographically and demographically the largest country in the sub-continent, India's increased economic strength has allowed it to become one of the largest aid providers in South Asia. However, it also gets engaged in diplomatic fallout with its neighbors Pakistan, Bangladesh, Nepal, and China, mostly over unresolved borders and water sharing issues. New Delhi's strained relations with its neighbors have particularly affected economic cooperation and integration in the region, which is glaringly clear in the dysfunctional regional bloc, the South Asian Association for Regional Cooperation (SAARC).⁸

China, on the other hand, has proved a reliable development partner that seems willing to provide much-needed infrastructure investments to smaller countries in the region. Pakistan, Bangladesh, Sri Lanka, the Maldives, and Nepal

3 Panda, Jagannath. P. "Build Back Better World Initiative: A Partnership Against or Beyond China?" Mannoahar Parrikar Institute for Defence Studies and Analyses, August 9, 2021. <https://bit.ly/3DbnlsD>.

4 World Bank. "Population, total - South Asia." <https://bit.ly/3TskwCS>.

5 Finnigan Christopher. "Poverty in South Asia: The Long View," Blogs London School of Economics, April 9, 2019. <https://bit.ly/3qoVWMI>.

6 Michalopoulos, Stelios, and Elias Papaioannou. "Series Introduction: Historical legacies and contemporary development." *The Long Economic and Political Shadow of History 2* (2017).

7 World Bank. "Overview." <https://bit.ly/3ey2l5e>.

8 Muzaffar, Muhammad, Iqra Jathol, and Zahid Yaseen. "SAARC: An Evaluation of its Achievements, Failures, and Compulsion for Cooperation." *Global Political Review 2*, no. 1 (2017): 36-45. <https://bit.ly/3RQJ11C>.

*Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka.

have all signed the BRI, through which large infrastructure projects like highways, railways, airports, seaports, hydroelectric plants and thermal power plants are being built across different countries. Over the past several decades, China's increased aid portfolio has not only translated into Beijing's increased influence in South Asia but also provided its recipient countries with an important leverage against India's hegemonic presence.

Traditionally, the U.S. has refrained from over-engaging in South Asia and instead relied on building a closer strategic partnership with India to pursue its interests in the region. However, Beijing's increased military strength, combined with its influential aid portfolio in South Asia and the broader Asia-Pacific region, has prompted Washington to adopt a more aggressive foreign policy, which is well articulated in its Indo-Pacific Strategy (IPS). Threatened by China's growing presence in its traditional sphere of influence, India has also abandoned its long-standing policy of non-alignment and entered into a strategic alliance with the U.S. and its allies, Australia and Japan, collectively known as the Quadrilateral Security Dialogue (QUAD). Although IPS prioritizes military cooperation and alliances, it can be argued that mobilizing increased aid and investments to the region to counter-balance Chinese economic influence also falls within the broader ambit of IPS.⁹

The Evolution of Aid and Infrastructure Diplomacy in South Asia

Cold-War Rivalry

Given South Asia's complex geopolitics and fraught relations among its member countries, donor countries have struggled to map out a coherent

foreign policy for the region. The U.S. provided foreign aid to both India and Pakistan while the countries suffered from food shortages after their partition in 1947. However, following the first war between the two countries, the U.S. struggled to balance its diplomatic relationship. On the one hand, it was suspicious about India's close ties with Soviet Russia, while on the other hand it was worried about Pakistan's increasing ties to China.

Meanwhile, China began prioritizing Pakistan after its war with India in 1962. Beginning with a USD 60 million interest-free loan in 1962, China's aid to Pakistan increased significantly in the following decades. Part of this Chinese aid went toward improving Pakistan's military capacity, the details of which were kept confidential. However, in the past few decades Pakistan has spent most of its aid money from China on constructing its strategic Karakoram Highway, which extends along the Himalayas, from China's Tibet region through Kashmir and up into the Pakistan-Afghanistan border, giving China access to the Middle East and Europe through Gwadar Port.¹⁰ This trans-Himalayan route, also known as the China-Pakistan Economic Corridor (CPEC), is one of the six BRI routes.

Besides Pakistan, Sri Lanka also received substantial aid from China during the Cold War period. The first Chinese aid to Sri Lanka was a USD 15.8 million grant in 1957 to improve its rubber plantations. The following year, China gave another USD 10 million loan for food relief, after which it provided further aid to invest in Sri Lanka's industrial infrastructures.¹¹ Chinese aid to Sri Lanka came at a time in the 1960s when its relations with the U.S. had deteriorated over the nationalization of its oil companies. As a result, trade with Beijing flourished and Chinese aid helped set up large industries and construction projects in Sri Lanka.¹²

9 Panda, Jagannath. P. "Build Back Better World Initiative: A Partnership Against or Beyond China?" Mannoahar Parrikar Institute for Defence Studies and Analyses, August 9, 2021. <https://bit.ly/3DbnlsD>.

10 Copper, John F. *China's Foreign Aid and Investment Diplomacy, Volume II: History and Practice in Asia, 1950-Present*. Springer, 2016. Pg 49-70.

11 Ibid Copper. Pg 50-51.

12 Ibid Copper.

During the Cold War, China also provided aid to Nepal for improving highways in the mountain districts near its borders and for setting up some of the country's first industries.¹³ The two countries have a long history of trade relations, when businessmen from Kathmandu and Beijing regularly travelled through the old Silk Route. However, the two country's new aid diplomacy began in 1956 after signing a formal trade and bilateral relations treaty. By then, the annexation of Tibet had already led to an influx of refugees into Nepal, and China was concerned about the potential security impact. Nepal's good relationship with post-Independent India meant that China could not extract too much leverage out of its aid to Nepal. Nevertheless, between 1960 and 1990, China invested in Nepal's infrastructure projects, such as the Araniko Highway and Prithvi Highway, which link Kathmandu to northern districts, including those that share borders with Tibet. Similarly, Chinese aid contributed to establishing new industries, such as the Hetauda Cotton Textile Mill, Bhaktapur Brick and Tile Factory, Bhrikuti Paper Mill, Gorakhkali Rubber Factory, and Lumbini Sugar Mill.¹⁴ While the Chinese did not wield much political clout in Kathmandu, the aid helped build China's reputation as a friendly neighbor that was contributing to Nepal's economic development. For Nepal, aid diplomacy with China was a pragmatic policy choice to maintain equidistance between its two giant neighbors, allowing it to benefit from foreign aid on either side.¹⁵

Another major donor in the region, the U.S., was already providing humanitarian aid to India and Pakistan after their difficult partition, which had

led to a large refugee crisis and food shortages on both sides.¹⁶ But the U.S. also focused its attention toward smaller countries like Nepal, especially after China's annexation of Tibet. The U.S. provided aid to set up Nepal's first telecommunications infrastructure. However, Washington did not expand its investments in hard infrastructures because Nepal had close ties with India, which had already been investing significantly in building Nepal's major highways, domestic and international airports, bridges, and hospitals. Nonetheless, the U.S. maintained its presence in the country through its Peace Corps volunteers, who have been deployed in large numbers since the 1960s to provide technical support across various sectors, including agriculture, health, education, and environmental conservation. Like China, this earned the U.S. a reputation in Nepal for being a friendly development partner.¹⁷

The end of the Cold War reduced insecurity for many countries, including those in South Asia that were caught in a turf-war between superpowers. The liberalization of India, Bangladesh, Sri Lanka, and Nepal through the World Bank's Structural Adjustment Plan (SAP) became a turning point for the inflow of aid and investments into South Asia.¹⁸ The U.S. in particular began to support economic reforms in order to obtain greater access to trade and investment opportunities in India and the greater South Asian region. Between 1990 and 1993, foreign direct investment (FDI) in India increased from USD 73 million to USD 3 billion, of which 42 percent were U.S. investments.¹⁹ However, these attempts were dampened due to the nuclear arms race between

13 Prasad, Uma Shankar. 2016. "Study of Nepal's Economic Relations with China". *Journal of Development and Administrative Studies* 23 (1-2):23-32. <https://doi.org/10.3126/jodas.v23i1-2.15446>.

14 Ibid Shankar

15 Muni, S.D. *Foreign Policy of Nepal*, Adroit Publishers, New Delhi, 2016.

16 Reddy, Y. Obi. "The US aid to India: A study in foreign aid diplomacy 1957-64." *The Indian Journal of Political Science* 58, no. 1/4 (1997): 93-110. <http://www.jstor.org/stable/41855752>.

17 Truong, Joseph. "USAID and Peace Corps Partner for Volunteers' Return to Nepal." *Blogs, United States Agency for International Development*, January 27, 2012. <https://bit.ly/3TXPMAe>.

18 Khan, Haider A., and Zulfiqar Larik. "Globalization and Regional Co-operation in South Asia: A Political and Social Economy Approach." *CIRJE-F-480 Discussion Paper* (2007). Pg. 31.

19 Gordon, Sandy. "South Asia after the Cold War: Winners and Losers." *Asian Survey* 35, no. 10 (1995): 879-95. <https://doi.org/10.2307/2645564>.

Chinese ODA to South Asia



Fig 1: Chinese ODA to South Asia has steadily increased in the past decade.

India and Pakistan, which threatened the stability of the region at the height of the 1999 Kargil War. The Maoist conflict in Nepal and Sri Lanka’s Liberation Tigers of Tamil Elam (LTTE) insurgency were other significant events in South Asia that posed a dilemma for donors, who became increasingly worried about the security of their aid money.²⁰

Around the same period, China began to focus more on expanding its trade and investments across the world. Deng Xiaoping’s Open Door Policy in the 1970s and 1980s led to successful ventures for Chinese investments abroad, which encouraged Beijing to make their next major foreign policy shift on aid and investments. With the beginning of a new millennium, China initiated its ‘Go Global!’ strategy,

a decisive step in China’s increased investments abroad. Between 2002 and 2006, Chinese overseas FDI stocks doubled from USD 30 billion to USD 73 billion and continued to grow at an astounding 20 percent until 2010.²¹ This placed China firmly as a major provider of aid and investments globally. The trend is similar in South Asia, where Chinese aid has consistently increased after 2006-07.

New Infrastructure Race

When China declared its BRI in 2013, some of the biggest initial investments were made to countries in South Asia. In Bangladesh, Chinese investment and construction contracts increased six times compared to the earlier period (2005-2013).²² The two countries

20 Gordon, Stuart. “Evaluating Nepal’s Integrated “Security” and “Development” Policy: Development, Democracy, and Counterinsurgency.” *Asian Survey* 45, no. 4 (2005): 581-602.

21 Bellabona, Paola, and Francesca Spigarelli. “Moving from open door to go global: China goes on the world stage.” *International Journal of Chinese Culture and Management* 1, no. 1 (2007): 93-107.

22 He, Alex. “The Belt and Road Initiative: Motivations, Financing, Expansion and Challenges of Xi’s Ever-Expanding Strategy. CIGI Papers 225.” (2019). Pg 6.

Total receipts from US, Japan and UK

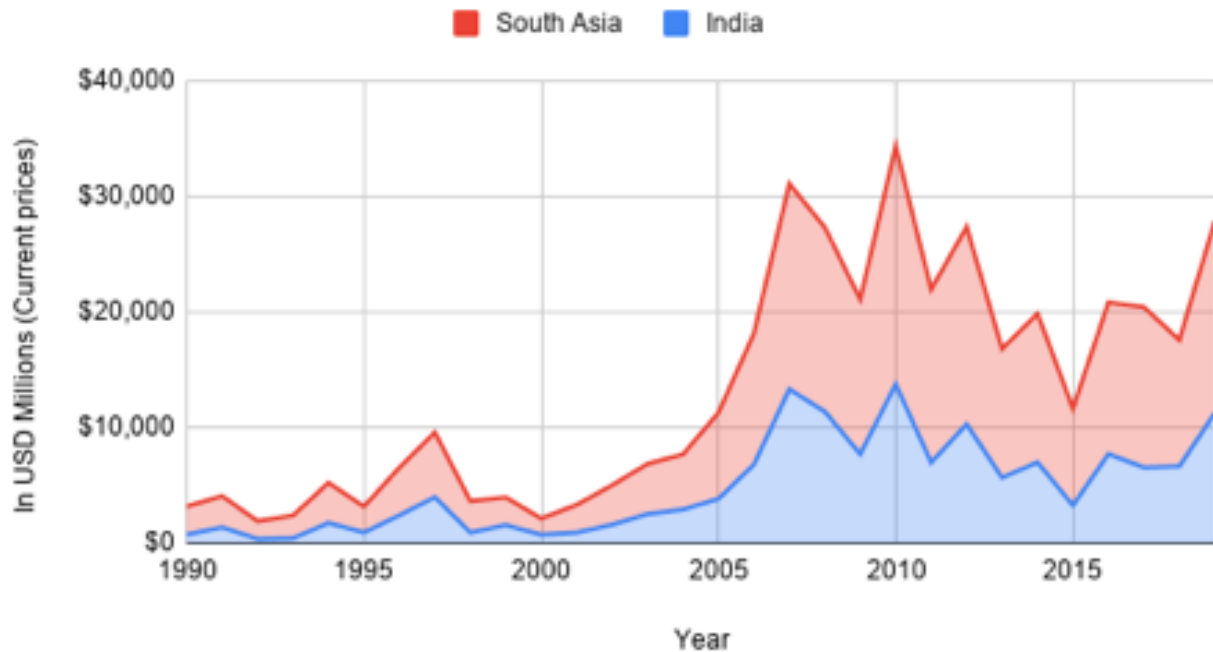


Fig 2: India accounts for a major share of foreign aid from the US and its DAC partners in South Asia, but the flow to other South Asian recipients has increased in recent years.

Source: OECD

signed 27 agreements worth USD 24 billion in 2016, making China Bangladesh's largest investor.²³ The investment funded a much-needed expansion and upgrade of Bangladesh's railways and highways, as well as thermal power plants and seaports that could prove crucial to augmenting growth. The amount of Chinese investments in Pakistan also increased three times in the first five years of BRI, in which Pakistan received large funding in construction contracts. Pakistan received a total of USD 39.51 billion in investments and construction contracts from China between 2014 and 2018, compared to USD 12.44 billion in the earlier period.²⁴ The cumulative value of China's infrastructure investments in Sri Lanka after

2006 is estimated at USD 12.1 billion. China invested at least USD 6.8 billion through 13 projects after launching the BRI in 2013.²⁵

Competing against Chinese aid and investments, the U.S. and its DAC allies also significantly increased their aid and investments after the turn of the millennium. In the past few years, at least two South Asian countries were selected for the MCC program, which involves a U.S. government grant of USD 500 million for infrastructure projects in the recipient countries.²⁶ However, the MCC aid was viewed as geopolitically sensitive and the program became politically contentious in both countries. While Sri Lanka decided to reject the compact aid after strong

23 Ramachandran, Sudha. "How Bangladesh Learned to Love the Belt and Road," *The Diplomat*, July 22, 2019. <https://bit.ly/2K1zdR7>.

24 Ramachandran, Sudha. "How Bangladesh Learned to Love the Belt and Road," *The Diplomat*, July 22, 2019. <https://bit.ly/2K1zdR7>.

25 Wignaraja, Ganeshan, Dinusha Panditaratne, Pabasara Kannangara, and Divya Hundlani. *Chinese investment and the BRI in Sri Lanka*. London: Chatham House, 2020. <https://bit.ly/3KXVUoa>.

26 Millennium Challenge Corporation. "U.S. and Nepal Sign \$500 Million Compact," September 14, 2017. <https://bit.ly/3B1CXfN>.

domestic opposition, Nepal accepted the compact money amid contestations.²⁷ Strong domestic opposition over the MCC emerges from a general perception that it is a part of a U.S.-led Indo-Pacific Strategy, which is viewed as a military alliance against China. This shows that the recipient countries are wary of getting caught in the geopolitical turf-war between superpowers.²⁸

Japan, Germany, France, the U.K., Denmark, Finland, Sweden, and Norway are other major DAC donors in South Asia that have been providing aid to support physical and social infrastructures across various sectors and promoting climate-friendly technology. Being strategic U.S. allies, their aid investments are seen as complementary rather than competitive with Washington. Nepal is a major recipient of aid from DAC countries. The USD 21 million grant support to Nepal's rural agriculture infrastructure, which was funded by Denmark under the UNNATI project (2013-18), significantly contributed to improving Nepal's agriculture sector.²⁹ Similarly, the Finnish government's USD 33.5 million support to rural water resource management³⁰ and the Norwegian government's USD 39.5 million support to improving energy access in Nepal's Province 2 are other significant grants. Germany's state-owned KfW Development Bank financed Nepal's 72 MW Madhya Marsyangdi Hydropower Project,³¹ which came into operation in 2008. Similarly, the Germans have also provided a USD 37.4 million grant to support the 220 kV Damauli-Lekhath (43 Km) transmission line.³²

Besides Nepal, Bangladesh also receives a large amount of foreign aid from DAC countries. In 2019, it

was the third largest recipient of official development assistance (ODA) from DAC countries, with a net disbursement of around USD 4382 million.³³ Among others, around USD 1277 million was provided by Japan while the U.K. provided USD 295 million during the same period. The aid was provided to support various economic and social infrastructures.

Overarching Observations

Limits of Western Aid

Aid provided by developed Western countries – bilaterally and through multi-lateral institutions – target poorer countries and invest in supporting basic human needs in health, education, agriculture and other infrastructures. However, multi-lateral institutions like International Monetary Fund, World Bank and Asian Development Bank, through which many western donors roll out their development support, promote neo-liberal policies defined by the Washington Consensus.³⁴ Similarly, these donor countries also advocate for a rules-based international order that include democratic freedoms and respect for political and human rights. Such conditional ties to aid are often at odds with domestic political systems and affairs in the recipient countries. For instance, between 1950 and 2008, on three instances, Nepal's constitutional monarch took over power by dismissing the elected parliament and civilian government. Similarly, Bhutan is still governed by a monarch that defines democratic freedoms that may not subscribe to standards set by Western democracies. There are other South Asian countries like Bangladesh and Sri

27 Bhattarai, Kamal Dev. "The Indo-Pacific Vs. the Belt and Road: Nepal's Great MCC Debate," *The Diplomat*, January 30, 2020. <https://bit.ly/3L12iez>.

28 Igoe, Michael. "In Sri Lanka, with 'great Power Competition' Comes Great Headaches for MCC," August 5, 2020. <https://bit.ly/3qngt3N>.

29 <https://openaid.um.dk/en/projects/dk-1-218722>.

30 Finland Abroad. "Finland's Development Cooperation in Nepal." <https://bit.ly/3RvDjIU>.

31 "Nepal Inaugurates 72-MW Middle Marsyangdi," *Hydroreview*, 12 December 2008. <https://bit.ly/3eBDldb>.

32 "Germany Announces Additional Grant for Damauli-Lekhath Transmission Line" *Nepal Energy Forum*, December 19, 2017. <https://bit.ly/3eBEiCi>.

33 OECD. "ODA to Developing Countries - Summary." <https://bit.ly/3AZcdfX>.

34 Bonal, Xavier. "Plus ça change... The World Bank global education policy and the Post-Washington Consensus." *International studies in sociology of education* 12, no. 1 (2002): 3-22.

Aid from India to South Asian countries

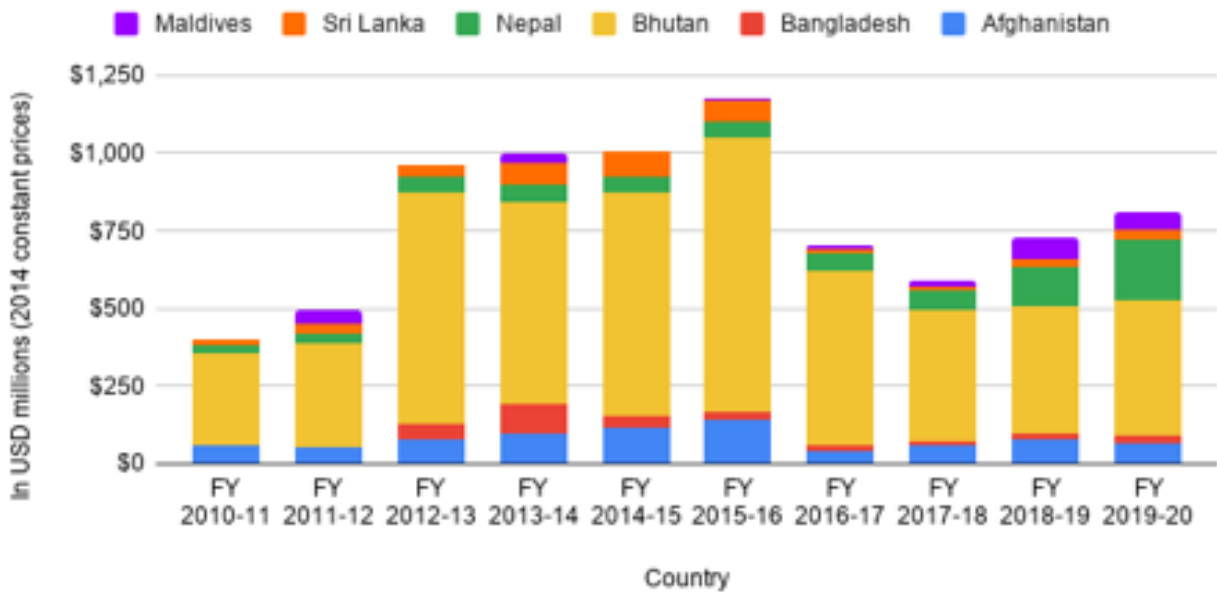


Fig 3: The distribution of India’s foreign aid to its neighbors in South Asia has been changing.

Source: Union budget, India

Lanka, where incidences of human rights violations and shrinking civic spaces have routinely raised donors’ concerns.

However, given that these countries remain underdeveloped and require foreign aid, they are bound to look beyond conditional aid provided by Western donors. China has been one of the most vocal critics of Western aid and has been advocating for more South-South cooperation among developing nations that cater to domestic needs and priorities. The demand-based aid provided by donors like China and India to smaller South Asian countries point towards the attraction of such unconditional aid and investments.

Another criticism of Western aid is its top-bottom approach, in which donors seem to take a lead in defining the priorities and the development framework in recipient countries. This only draws more criticism about their supposed agendas and geopolitical interests in the recipient country. To

be sure, there has been a lot of rethinking among Western donors, who are now looking at aid as an investment in development partnerships. This could help them gain more traction in the developing world, including in South Asia.

China is Not New in the Region

In recent years, many Western observers have begun studying and writing about what they see as China’s expanding footprint in South Asia. However, for those closer to the region, China has always been engaged in the subcontinent, which was an important trade hub and gateway to the rest of Asia and Europe under the ancient Silk Road.³⁵ Also, Beijing’s aid diplomacy in South Asia dates back to the years of Cold War when it had security concerns after the annexation of Tibet. Providing aid to Sri Lanka and Nepal was crucial for Beijing, which needed friendly neighbors after the West refused to recognize Mao Tse Tung’s communist government.

35 Roy, Pawan & Pant Saurav Raj. “Silk road here we come,” The Kathmandu Post. 07 April 2017.

For Sri Lanka, Chinese aid came at a crucial time, when it had just gained independence from British colonialism. Its relations with the West had become strained in the 1960s, when the government in Colombo nationalized petroleum oil companies, which directly affected U.S. and British companies.³⁶ Similarly, Chinese aid from the north proved important for landlocked Nepal, which was looking to counterbalance the influence of its southern neighbor India. Aid to Pakistan also became crucial in that regard, as both countries had fought wars with India and were looking for an ally to reduce their own insecurity. Despite Pakistan's strong strategic relations with the U.S. during the Cold War, China was able to establish cordial diplomatic ties, which gradually became a strong development partnership as Beijing funded large infrastructure projects in Pakistan.

This indicates that China has been an influential donor in the region since the Cold War period and has only expanded its footprint in the region since announcing its ambitious BRI project in 2013. South Asia's large demography and emerging economy offers a large market for Chinese traders, industries, and investors.

India as a Donor and Recipient

Despite its demographic and military strength, India continues to strive for greater economic growth, maintain influence over its neighbors and consolidate its power in the region. This has become especially critical due to China's increased geopolitical and economic footprint in the region. However, India's own domestic investment needs for the future have swelled to at least USD 1.5 trillion

over the next decade.³⁷ Even with the ever-growing size of its economy, which has reached over USD 2.5 trillion in GDP, India cannot finance this gap on its own. The primary reason for this is its huge defense spending, which is over 15 percent of government's annual budget expenditure.³⁸ India's obligation to provide aid to its strategic partners, including its close neighbors in South Asia, has also stretched its resources. In its budget for the fiscal year 2020-21, India allocated USD 2.5 billion dollars for its external affairs, out of which USD 966 million was foreign aid spending. A big chunk of that aid, over 71 percent, was allocated to South Asian neighbors, like Bhutan, Nepal, Maldives, and Bangladesh.³⁹

These figures are impressive given the fact that India's foreign aid spending was a modest USD 442 million a decade ago.⁴⁰ Despite struggling to meet its domestic infrastructure gaps, India has increased its foreign aid spending in response to China's aggressive aid diplomacy in the region. This has become possible due to India's strategic alliance with the U.S., which is a recent departure from its Cold War era strategy of non-alignment. India's alliance with the U.S. is driven by its own necessity, but it is also a strategic response to China's belligerent presence in the region. In any case, it has ensured India a sustained FDI flow and other strategic aid from the U.S. and its allies to fund its domestic infrastructures.⁴¹

South Asian Agency and Pragmatism

During the Cold War, many developing countries had high levels of poverty, illiteracy, malnutrition and poor economic growth and desperately needed foreign aid to improve their human development indices. They also had limited technical capacity

36 Kodikara, Shelton U. "Major trends in Sri Lanka's non-alignment policy after 1956." *Asian Survey* 13, no. 12 (1973): 1121-1136.

37 labona, Paola, and Francesca Spigarelli. "Moving from open door to go global: China goes on the world stage." *International Journal of Chinese Culture and Management* 1, no. 1 (2007): 93-107.

38 Pandey, Aparajit. "India's Infrastructure Challenges: Domestic Constraints and Geopolitical Opportunities." *Orfonline*, 29 September 2017. <https://bit.ly/3x9opti>.

39 Behal, Ritika. "Defence Budget 2020-21: An Analysis." *Defence eProcurement Portal - Ministry of Defence, India*. <https://defproac.com/?p=10655>.

40 Piccio, Lorenzo. "India's Foreign Aid Program Catches up with Its Global Ambitions." *Devex*, 10 May 2013. <https://bit.ly/3RMWlUz>.

41 Press Trust of India. "US Body Announces \$54 Million Investment in India to Support Infrastructure Projects," *The Times of India*. 23 December 2020. <https://bit.ly/3KXLzsp>.

to engage with the dominant regional and global powers in aid diplomacy. Yet, we have already discussed how smaller South Asian countries like Sri Lanka, Nepal, and Pakistan made pragmatic choices in their foreign aid to fulfill domestic needs and safeguard their national interests.

Today, these countries have much larger economies, more human resources capacity, and an increased willingness to engage with different donors on areas of mutual interests. This highlights an important point: Developing nations cannot just be looked upon as passive recipients of aid. While non-alignment remains a cornerstone in the foreign policy of smaller South Asian countries, they are increasingly becoming strategic in their aid diplomacy. While negotiations at the government level are decisive, domestic public discourse around aid and infrastructure diplomacy are becoming crucial in shaping policy decisions in recipient countries. The discourse around these decisions may not always be robust, but they increase the domestic political stakes for recipient governments and the political actors at their helm.

New Infrastructure Diplomacy: Implication for Nepal and Smaller Recipient Countries

New Opportunities

Poor infrastructure, stunted growth, and poverty have formed a vicious cycle that poses serious challenges to South Asia. To overcome its infrastructure gap and meet the requirements of member countries, it is estimated that the region will require an annual outlay of around USD 423 billion.⁴² Expected deficits to this end are estimated to be around USD 200 billion on a year-to-year basis.⁴³ A large share of this deficit accounts for the investment requirements of India, but it is equally a hindrance to the growth aspirations

of smaller countries like Bangladesh, Nepal, and Sri Lanka, who have comparatively low levels of domestic capital mobilization unlike India. However, in recent years, smaller countries in the region have received large bilateral aid and investments to fund their infrastructure gaps due to geopolitical competition among donor countries. These countries receive aid provided by the U.S. and its other DAC allies while also benefitting from China's generous aid under the BRI. Besides Pakistan, other South Asian countries have also benefitted from Indian bilateral aid. For instance, Bangladesh has brought in aid to shore up its infrastructures in the transport sector and energy generation; Sri Lanka has improved its seaports and other infrastructures; and Nepal has been prioritizing hydropower generation, tourism infrastructures, and transportation and irrigation projects. As the geopolitical rivalry among donors intensifies in the region, more aid money may be available to these countries through bilateral and multilateral mechanisms. However, the opportunities bring their own set of concerns, especially in recipient countries that have weak governance. In the recent years, civil society and media in some countries have faced government restrictions for demanding greater transparency and accountability over aid mobilization.

Managing Tensions

Smaller countries in South Asia have tried to be pragmatic in their aid diplomacy and have mostly avoided getting caught in a geopolitical quagmire among powerful donor countries. But they often struggle to do so, not only due to increased competition among donors but also due to their domestic political environment. In 2021, Sri Lanka rejected the U.S. government's MCC grant aid of \$500 million after domestic political pressure. However, that has not prevented the country from sliding into a political and economic crisis, which is being blamed on mismanagement of the

42 Asian Development Bank. "Meeting Asia's Infrastructure Needs | Asian Development Bank," February 27, 2017. <http://dx.doi.org/10.22617/FLS168388-2>.

43 United Nations Economic and Social Commission for Asia and the Pacific. "Financing sustainable infrastructure development in South Asia: the case of Asian infrastructure investment bank (AIIB)." (2019).

economy and poor aid diplomacy, particularly with regards to BRI projects. Nepal, on the other hand, decided to accept the MCC aid money. But despite clarifications from senior officials in both donor and recipient countries, there is still a lot of discontent and misgivings that the aid compact could have hidden strategic bearings and lead the country into a geopolitical trap between superpowers.⁴⁴ More than anything, the contestations around foreign aid in both countries are a product of internal struggle among domestic political constituents. Bangladesh is a better example of how recipient countries can maintain a strategic balance and benefit from aid and investments amid competing donor interests. As the competition among donors intensifies, however, even Dhaka might struggle to consistently maintain this fine balance.⁴⁵

Implications for South Asia

Once a politically unstable conflict zone, South Asia is undergoing a rapid change in terms of economic

and infrastructure development. Although the global COVID-19 pandemic has punctuated growth across much of the developing world, South Asian countries have shown resilience in terms of reviving their economies. They continue to make high levels of investments in their physical infrastructures that promote regional connectivity and are supported by major development partners, including bilateral donors like China, India, the U.S. and its DAC allies, like U.K., Japan, Germany and France. While India, Afghanistan, and Pakistan remain a centerpiece of geopolitical rivalry among the big donors, smaller countries like Nepal, Bangladesh, and Sri Lanka will continue to attract more aid and investments in the coming years. The stability and prosperity of the region will depend more on how the smaller recipient countries negotiate their needs and priorities against competing donor interests. As the region becomes more interconnected through better infrastructure and larger trade between neighbors, South Asia's strategic value will only increase.

44 Igoe, Michael. "In Sri Lanka, with 'great Power Competition' Comes Great Headaches for MCC," 05 August 2020. <https://bit.ly/3eECGIg>.

45 Yasmin, Lailufar. "India and China in South Asia: Bangladesh's opportunities and challenges." *Millennial Asia* 10, no. 3 (2019): 322-336.



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