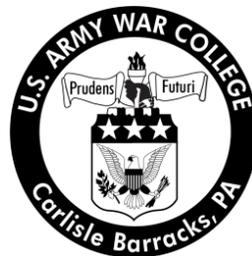


# Strategy Research Project International Fellow

## Chinese Policy Toward South Asia: Implications and Prospects for Nepal

by

Brigadier General Jagadish C. Pokharel  
Nepalese Army



United States Army War College  
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Brigadier General Jagadish C. Pokharel  
Nepalese Army

Dr. Larry P. Goodson  
Department of National Security and Strategy  
Project Adviser

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U.S. Army War College  
CARLISLE BARRACKS, PENNSYLVANIA 17013



## **Abstract**

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China is taking bolder steps to strengthen its position vis-à-vis the United States in South Asia. Chinese involvement in South Asia is mostly focused on the two nuclear countries of the subcontinent, India and Pakistan. After the Cold War, relations among the United States, China and India changed significantly. A new asymmetric triangular formation dominated by the United States depicts the strategic relations in South Asia. China and India both have emerged as the growing powers in Asia. Although China had long border tensions with India, bilateral trade relations have improved recently. Now China has become the largest trading partner of India. In this context, this paper focuses on China's strategic intentions with India. This paper has also examined the possibilities of Nepal becoming a bridge between the two rapidly growing economies, both to benefit them and Nepal.



## **Chinese Policy Toward South Asia: Implications and Prospects for Nepal**

*Only when China and India develop well, can one claim that the century of Asia has come. If China and India strengthen cooperation, Asian unity, stability and prosperity will be very hopeful; the world will be in peace and make more progress.<sup>1</sup>*

Deng Xiaoping

### Overview

Half a century ago, geographers described China as an isolated “Middle Kingdom” with very limited contact with the outside world and less influence over the Eurasian and American world. It remained isolated from South Asia by the Himalayan mountain region. After Mao Zedong came into power in 1949, China was still isolated from many countries of the world. In 1954, China had signed an agreement with India based on Five Principles of Peaceful Coexistence, widely known as “Panchsheel.” Despite signing the treaty under “Panchsheel,” China attacked India in 1962 and occupied about 38,000 square kilometers Indian territory. In addition, under the Sino-Pakistan “boundry agreement” of 1963, Pakistan has ceded approximately 5,120 square kilometers of Pakistan-occupied-Kashmir area to China.<sup>2</sup> After the war Sino-Indian relations were poor. Pakistan became one of the first South Asian countries to recognize China after the Chinese Communist revolution. The Sino-Indian War of 1962 became a boon to improve bilateral relations between China and Pakistan. Since then Sino-Pakistani relations have been maintained closely. China has become Pakistan’s major arms supplier, and trade relations have also been strengthened in the recent past. Both China and India have increased their maritime trade through the Indian Ocean. These increasing activities in the Indian Ocean have been global concerns

because China and India are emerging as the twenty-first century economic powers, and both are strengthening their own geostrategic positions. Geostrategic competition between these two Asian giants is growing and both are rapidly developing their hard power capabilities commensurate with their rising statures in global affairs.

India is Nepal's main trading partner with a long political and cultural relationship. China is also increasing its engagement in Nepal lately and Nepal has been giving equal importance to China, establishing diplomatic relations in 1955, and the only country having diplomatic representation in Lhasa. Nepal supports the "One China Policy." The geostrategic location of Nepal is important to both China and India because it could serve as a bridge between these two Asian giants in view of their growing economies and trade relationships. However, Nepal needs to improve its infrastructure in order to better serve as a bridge between these two countries. Nepal should upgrade the proposed Asian Highways that pass through Nepal, which would enhance trade between China and India through Nepal. Additionally, the development of good road network would be advantageous for both India and China to harness Nepal's hydroelectricity and tourism potential.

This paper will discuss Chinese policy toward South Asia, especially scrutinizing the Sino-Indian relationship at various stages. It will examine possible aspects of economic cooperation including trade and commerce between China and India and the various possibilities of how Nepal will benefit while acting as a "bridge between two giants." First, it will discuss the strategic relationship among the United States (U.S.), China and India. Second, it will discuss the Chinese policy toward South Asia within the

context of China-India and China-Pakistan relations. Third, it will identify the Nepal's critical role as a bridge between China and India.

### Strategic Relationship among the U.S., China and India

After the Cold War, relations among the United States, China and India have changed significantly.<sup>3</sup> A new asymmetric triangular formation characterizes contemporary strategic relations in South Asia under U.S. influence. The emergence of these regional powers has led to the development of tri-polar relationships among the U.S., China and India. While meeting the Chinese Vice President Xi Jinping (now he has been elected President of China), U.S. President Barack Obama in February 2012 said that the United States will boost trade and commerce in the region in order to strengthen the U.S.-China relationship. President Obama said [China is] “a strong and effective partner with the Asia Pacific region...it is absolutely vital that we have a strong relationship with China.” President Obama further said he has “always emphasized that we welcome China’s peaceful rise ... we believe that a strong and prosperous China is one that can help to bring stability and prosperity to the region and to the world.”<sup>4</sup> China has become a strong regional power, and thus, it is essential to make China respect its neighbors and commit for regional and global peace and stability.

The United States has also strengthened its relationship with India. The relationship between the U.S. and India has grown much stronger as U.S. Deputy Secretary of State William J. Burns says, “Never has there been a moment when India and America mattered more to one another. And never has there been a moment when partnership between India and America mattered more to the rest of the globe.”<sup>5</sup> The

U.S. has strengthened its relations with India not only to balance China, but also because of the strategic important role India might play in global security environment.

On October 2008, Congress gave final approval to the agreement facilitating nuclear cooperation between the United States and India. This agreement paved the way for their strategic relationship to pursue common interests in fighting terrorism, spreading democracy and human rights, as well as preventing Chinese domination in the region. In this connection Charles D. Ferguson, science and technology fellow at the U.S. Council on Foreign Relations, rightly said, “it is the China’s rise in the region what has prompted the U.S. to seek a strategic relationship with India to counterbalance China.” However, foreign relation experts do not think that a strong U.S.-India relationship would be a threat to a growing Sino-Indian economic relationship.<sup>6</sup> Though Sino-Indian economic relationships might grow over time, John Ikenberry does not see any chances of weakening the U.S. influence in Asia because of current security and economic interdependence. However, the most likely scenario will be a redistribution of power, which could be attributed to the voting rights in the United Nations Security Council.<sup>7</sup> A remote possibility is that as the economic ties between China and India strengthen, these two Asian powers might jointly stand and challenge the present world order and the role of the U.S. However, given the political and ideological background of these two Asian giants, the likelihood of them jointly undermining the U.S. influence in Asia is very remote and almost non-existing.

Bilateral trade between the U.S.-China in 2012 was \$536.2 billion<sup>8</sup> and between the U.S.-India it was \$62.5 billion.<sup>9</sup> Similarly, the trade between China-India in the same year was about \$66.4 billion.<sup>10</sup> There are 1,458,219 active duty military personnel in the

U.S. military, 2,285,000 in the Chinese military, 1,325,000 in the Indian military, and 191,000 in the German military.<sup>11</sup> The U.S. military budget for the year 2012 was \$711 billion (4.7% of GDP) the Chinese military budget was \$143 billion (2% of GDP), the Indian military budget was \$48.9 billion (2.6% of GDP), whereas the German military budget was only \$46.7 billion (1.3% of GDP) for the same period.<sup>12</sup> These statistics show that these three nations are large trading partners and the military budget of these three nations is also high compared to the German military budget. Equally, these three countries are advancing in the field of information and technology and diplomatically influencing world affairs through various regional and international organizations.

At present, some differences surface among these three nations, especially in the bilateral trade imbalance between the U.S. and China, valuation of Chinese currency, status of Taiwan and Tibet and China's rigidity for "One China Policy" and the U.S. not fully endorsing it, unresolved border issues between China and India, and recent Chinese territorial issues particularly in the South China Sea. The increasing military spending indicates that there is a competition between India and China as well as between China and the U.S. Though the U.S. is far ahead of India and China in military strength with advanced military technology and armed forces, the recent launch of China's first generation multi-purpose carrier-borne fighter jet known as the J-15 indicates that Chinese military is trying to close the gap with the U.S. military. The U.S., however, has the upper hand in terms of military power for at least another 15-20 years.<sup>13</sup> Nonetheless, the U.S., China and India have chances to cooperate in the field of economic development, including trade and commerce, while putting the other issues aside.

## China and South Asia

Despite being geographically isolated by the Himalayan mountain range from South Asia, China's role in South Asia is very significant.<sup>14</sup> China shares a common border with four South Asian nations (India, Pakistan, Nepal and Bhutan), while the other three (Bangladesh, Sri Lanka and Maldives) do not share borders with China (Map 1). Nepal and Bhutan are situated along the Himalayan range and act as the buffer states between China and India. Though China had a long history of border tensions with India, the cross-border investment and trade continue to take precedence over past security conflicts. China is taking bolder steps to strengthen its position vis-à-vis the United States across Asia in general and South Asia in particular.<sup>15</sup> Chinese involvement in South Asia is mostly focused on the two largest countries of the subcontinent, India and Pakistan.



Map1- Southern Asia

With reference to the changing Chinese strategies, Lawrence Saez writes that Chinese policy toward South Asia has shifted subtly and may be experimenting with and pursuing a variety of strategic options like balancing multilateralism with peripheral stability and the pursuance of other security objectives (such as energy security). He further writes that with respect to South Asia, China is pursuing a policy of *reluctant competition* with India; *contingent cooperation* with Pakistan, Bangladesh and Sri Lanka; and *secretive cooptation* with Nepal and Maldives.<sup>16</sup> Pursuing this strategy at regional level, China has joined the South Asian Association of Regional Cooperation (SAARC) in 2007. China has been participating in all SAARC Summits regularly after its admission in 2007 after it got observer's status.

The newly elected fifth generation leadership in China has the option to follow the existing policy or modify its policy toward South Asia. However, it is likely that new leadership will also focus on its economic engagement including trade and commerce with South Asia, especially with India. In general, Chinese foreign policy has been guided by the following principles:<sup>17</sup>

- Improving relations with the developed countries,
- Strengthening friendly relations with neighboring countries,
- Enhancing cooperation with the Third World,
- Actively participating in multilateral diplomacy,
- Adhering to exchanging and cooperating with other parties and political organizations,
- Extensively developing people to people exchanges.

## China-India Relations

China and India are the two most populous nations in the world as well as Asia's oldest civilizations. Cultural and economic relations between these two countries date back to ancient times. In those days the 'Silk Road' connected East, South and West Asia with Mediterranean and Europe as well as parts of North and East Africa. The Silk Road not only served as a major trade route between India and China, but was also credited for the expansion of Buddhism in this region. India gained independence in 1947, and China emerged as a new nation after the Communist revolution in 1949. China and India signed an agreement in 1954 based on Five Principles of Peaceful Coexistence known as "Panchsheel."<sup>18</sup> The five principles of Panchsheel include; mutual respect for each other's territorial integrity and sovereignty, mutual non-aggression, mutual non-interference in each other's internal affairs, equality and mutual benefit, and peaceful coexistence.

The Tibetan uprising of 1959 upset the delicate balance of Sino-Indian relations. In 1959, Dalai Lama fled from Tibet to Dharamsala in India, where he formed a Tibetan government-in-exile, still in existence today. China launched a surprise attack on India in a dispute over their long common border, which is extended to 3,440 kilometers.<sup>19</sup> In 1962 October this attack took place as the world focused on the Cuban Missile Crises. This War led to an almost complete breakdown in the Sino-Indian relationship.<sup>20</sup> After the War of 1962, the border dispute between India and China remained unresolved until today. Soon after the 1962 War a massive military buildup developed on both sides of the border. The two sides deployed more than 400,000 troops, with eight infantry divisions by the Chinese and eleven mountain divisions by the Indians.<sup>21</sup> During the

Indo-Pak War of 1965, China sided with Pakistan. Again during the Indo-Pak War in 1971, which led to the birth of Bangladesh, Sino-Pak cooperation was evident at diplomatic and military levels, but there was not any major military mobilization by China. Efforts were made to improve Sino-Indian relations, but it was not until 1976 that both countries again exchanged ambassadors in New Delhi and Beijing. Subsequently, Indian Prime Minister Rajiv Gandhi's visit to Beijing in 1988 and Chinese premier Li Peng's visit to New Delhi in 1991 helped to improve Sino-Indian bilateral relations. The Indian nuclear test in 1998 and the assertion by the Indian Defense Minister that China is "potential threat number one" was a wake-up call to China, which caused the bilateral relationship between China and India to deteriorate.

High-level visits and meetings between the leaders of China and India have contributed to slowly improving the bilateral relations. The progress in the field of trade and commerce has been encouraging, but it has not moved well in other fields, especially to address the unresolved boundary dispute between two countries. The fourth round of defense dialogue was held between China and India in New Delhi on December 2011. In this meeting China was led by People's Liberation Army (PLA) Lieutenant General Ma Xiaotian and India by Defense Secretary Shashi Kant Sharma.<sup>22</sup> Such meetings would definitely be helpful to clarify unresolved issues between the two countries and to strengthen the bilateral relationship.

### China-Pakistan Relations

China-Pakistan relations started from 1950 when Pakistan broke its relations with Taiwan and recognized People's Republic of China (PRC). Pakistan is one of the first countries to recognize the PRC. Sino-Pakistan ties gained momentum after the Sino-

Indian War of 1962, when China and Pakistan signed a border agreement recognizing Chinese control over portions of the disputed Kashmir territory.<sup>23</sup> Since then, the two nations have maintained cordial relations and high-level delegations have visited both capitals. In the early 1970s, Pakistan enabled China to cultivate its ties with the West as well as facilitating Henry Kissinger's secret visit to China in 1971. Chinese assistance to Pakistan has steadily increased, especially in the economic, military and various technical fields. China replaced the United States as its principal arms supplier when Washington imposed military sanctions on Pakistan in 1965, 1990 and also in 1998.<sup>24</sup> China has also assisted Pakistan on its nuclear and conventional defense capabilities.

The Beijing-Islamabad "special relationship" is a part of China's grand strategy that influences the South Asian security environment. Despite some improvement in Sino-Indian relations, Pakistan remains the linchpin of Beijing's South Asia policy. Pakistan is the only country that stands up to India and thereby prevents Indian dominance over the region; Islamabad indeed fulfills the inner goals and key objectives of China's South Asia policy.<sup>25</sup> The Sino-Pakistan relationship also provides a good example of containing India's bullying attempts over the South Asian countries.

Chinese cooperation with Pakistan has been extensive, substantial Chinese investment has been made in the field of Pakistan's infrastructural development. In addition to assistance with strategic infrastructure projects, China is also Pakistan's largest arms supplier, selling everything from aircraft to missiles to naval vessels. Nearly 70 percent of Pakistani military hardware originates from China.<sup>26</sup> The total trade volume between Pakistan and China has risen from less than \$1 billion in 2001 to about \$10 billion in 2010.<sup>27</sup> The two countries are committed to achieve a trade target of \$15

billion by 2015.<sup>28</sup> The growing economic and military ties between China and Pakistan indicate the importance of their bilateral relationship.

### Competition for Control of the Indian Ocean

The Indian Ocean is the third largest body of water in the world. The main sea lane connecting the Pacific Ocean and the Atlantic Ocean passes through the Indian Ocean.<sup>29</sup> Most of the Chinese and Indian maritime trade will have to pass through the Indian Ocean. Hence, safety and security of shipping in the Indian Ocean is of critical importance to India and China. Recent events in the South China Sea indicate that China is deliberately moving ahead to safeguard its interests. The aggressive posture of China in South China Sea makes India more cautious to defend its backyard in the Indian Ocean.

Pakistan's deep water-port Gwadar, constructed with Chinese help, provides the optimal strategic location for trade through the Arabian Sea connecting to the Strait of Hormuz and the Persian Gulf. Construction of the Karakoram Highway, crossing some of the highest points in the world, to connect China to Gwadar, will be of strategic value to both China and Pakistan and will connect China to Middle Eastern oil. This will be the 21<sup>st</sup> Century version of the Silk Road. China has been supporting Sri Lanka for the construction of the Hambantota Port project at the juncture of the Arabian Sea and Bay of Bengal. Bangladesh has also received assurances from China to build a deep-sea port at Sonadia and a Chittagong-Kunming Highway *via* Myanmar. Likewise, China is also constructing the deep-sea port of Kyauk Phyu in the western Raknine State of Myanmar, near the Shwe gas field.<sup>30</sup> The Shwe gas field is considered one of the world's largest natural gas reserves. Myanmar has already started working on an oil

pipeline and railway line from Kyauk Phyu (Sittwe) to southwestern China's Yunnan province (Map 2).



Map 2- Indian Ocean

On top of the construction of the above-mentioned strategic projects, China has displayed its interest to build closer relations with countries surrounding India. Harsh V. Pant says that the Chinese announcement of a \$500 million economic assistance package to the Maldives in September 2012 is an example of its concerted effort to encircle India.<sup>31</sup> India views the Maldives as central to the strategic landscape in the Indian Ocean. India is also worried about the Chinese effort to forge strong ties with Seychelles and Mauritius in past years. Some writers have termed this encirclement of India as a Chinese “string of pearls” strategy. About the Indian worry of its encirclement

by China, Robert D. Kaplan says, “China is merely seeking to protect its own sea lines of communications with friendly, state-of-the-art harbors along the way. But India feels surrounded.”<sup>32</sup> The Chinese have significant economic and strategic stakes in the Indian Ocean and are concerned about the economic lifelines at sea. These activities show that the strategic priority of planners in Beijing is to consolidate China’s influence in the Indian Ocean, which indicate the increasing Chinese and Indian competition to control the Indian Ocean.

### Economic Cooperation or Rivalry

China and India were ancient political and cultural powers that dominated their regions and beyond. It has been 50 years since the 1962 border war, however, and a permanent solution has not been found yet. As Robert Kaplan writes, a new power rivalry is taking shape between India and China, Asia’s two behemoths in terms of territory, population and richness of civilization. He also writes that the cause of the new rivalry is the collapse of distance brought about by the advance of military technology.<sup>33</sup> This indicates that China and India will remain long-term, if not permanent adversaries.

Despite their other differences these two adversaries, China and India, are improving their economic ties. During the last decade, on average the Chinese economy grew at 10 percent per annum and the Indian economy by 6 percent per annum. China and India continue to attract a high rate of investments, at 42 percent and 35 percent of gross domestic products (GDPs), respectively, in 2009. The levels of gross domestic fixed capital formation in China and India are the highest in the world. Trade between these two countries was about \$18 billion in 2005 and in 2012 it has crossed \$66 billion. Trade volume is expected to reach \$100 billion by 2015. From 2008

China has been the largest trading partner of India. These are some examples how two economic competitors are using trade as an integral part of the burgeoning bilateral relationship between them.

China and India find themselves in direct competition within global and regional markets. India realizes that the only way to beat China economically is to become more competitive.<sup>34</sup> In this context, the Indian Home Minister P. Chidambaram said, “India should not fear competition from Beijing or be envious but should, if at all, emulate its northern neighbor.”<sup>35</sup> These expressions indicate that India is aware of and prepared to compete with the Chinese strategy. Their competition for global trade, control of sea lanes, and military power will continue at least for the immediate future.

#### Nepal between Two Asian Giants

Nepal is located between the two rapidly growing powers of Asia-China and India. A balanced security strategy to deal with these two giants has always been a major and overriding concern for Nepal since its unification in 1769. Nepal’s foreign and security policy have basically evolved against the backdrop of concurrent but separate threats posed by two forces, the British East India Company (i.e. British Raj in India) in the South and Chinese presence in Tibet in the North. And Nepal has the distinction of always maintaining sovereignty and independence during the period of British colonialism and being endowed with legendary fighters of world fame.<sup>36</sup> Nepal is the melting pot where two important religions, Hinduism and Buddhism are being practiced. It is believed that Hinduism exists since 1200 BC<sup>37</sup> and Buddhism since 520 BC.<sup>38</sup> Buddha was born in Nepal, enlightened in India, and Buddhism spread to China, Central Asia and East Asia.

Even after India had achieved independence from Britain in 1947, Nepal-India relations continued to be based on foundations laid by the 1815 Treaty of Sugauli and the 1923 Treaty of Friendship signed with the Government of British India. The 1950 Treaty of Peace and Friendship concluded by the last Rana Prime Minister of Nepal with India is another important feature of Nepal-India relations.<sup>39</sup> Nepal's relations with China are regulated by two agreements – the 1956 Treaty of Peace and Friendship and the 1961 Border Agreement, between the two countries. During the 1962 Sino-India War, Nepal asserted its neutrality.

India is the most significant external economic actor in Nepal; however, China is rapidly increasing the level of its engagement. In terms of trade, India is Nepal's main trading partner constituting about 50 percent of its trade, whereas China had about 19 percent in 2010.<sup>40</sup> Chinese trade is growing fast and it has dramatically increased its aid to Nepal in recent years.<sup>41</sup> It is believed that the ongoing Lhasa (Tibet Autonomous region)-Khasa (Nepalese border town) rail link will be a game-changer in terms of trade relations and geopolitics in the region. It will reduce Nepal's dependency on India for its international trade, while helping to boost trade with China. Nepal could also potentially become a land gateway for Chinese trade and commerce with South Asia as a whole and India in particular.

However, the southern expansion of the Chinese railway network may cause concern to India with the suspicion that the same route could be well exploited by Chinese forces for their rapid deployment near to the Indian borders.<sup>42</sup> In the current state of Sino-India relations when both countries are focusing on positive aspects rather

than dwelling on contentious issues, a stable Nepal should be welcome to both countries.

### Nepal-China Relations

Friendly relations, including trade and other exchanges, between Nepal and the Tibetan Autonomous Region of China have been maintained for centuries. Chinese academics and officials stress that the two countries have a 2,000-year long history of traditional friendship and contact.<sup>43</sup> Nepal's historical relations with China have been shaped by the conflict over the territory and control of Tibet. The first war between Nepal and Tibet was fought in 1788, the second in 1792, and the third conflict occurred in 1855.<sup>44</sup> Formal diplomatic relations between China and Nepal were established in 1955 and resident ambassadors were exchanged in 1960. In 1956 both the countries signed the Treaty of Peace and Friendship replacing the Treaty of Thapathali, and Nepal agreed to the "One China policy," recognizing Chinese sovereignty over Tibet. In 1961 the Sino-Nepal "Boundary Treaty" was signed between the two countries.<sup>45</sup> Nepal shares a 1414 kilometer long border with the Tibetan Autonomous Region of China.

Nepal is the only country that maintains diplomatic representation in Lhasa, and Beijing reminds Kathmandu with ever greater regularity the responsibility that flows from that privilege. Beijing considers the crackdown by the Nepalese Army on the Khampa rebels in 1974 as a major favor from Nepal. Likewise, Nepal and China support each other in various international fora including the United Nations. Nepal supports the 'One China' policy and Nepal is committed not to allow its territory to be used against any of its neighbors. China emphasizes three policy determinants in its relations with Nepal. First, the relationship is based on the Five Principles, or "Panchsheel". Second, China

will not intervene in Nepal's domestic politics. Third, China expects Nepal's support on issues concerning China's sovereignty and national interests.<sup>46</sup> After the establishment of diplomatic relations in 1955, both the countries exchanged various high-level delegations to Beijing and Kathmandu, and have been able to maintain a friendly relationship. During Chinese Premier Wen Jiabao's visit to Nepal in early 2012, the two state leaders declared 2012 to be Nepal-China Friendly Exchange Year.<sup>47</sup> Accordingly, many high-level delegations visited China and Nepal in 2012.

### Nepal's Critical Role as a Bridge between China and India

Nepal can bridge between China and India due to its strategic location. Over 250 years ago, in his *Divya Upadesh*, King Prithivi Narayan Shah laid out nine principles that formed the core of Nepalese political and national life. In one of those principles he said "Nepal is a yam between two rocks." Thus, Nepal should take into consideration the strength of its neighbors and endeavor to use diplomacy and soft power in its foreign relations. King Prithivi Narayan Shah also asked his successors to be wary of the English and friendly to the Chinese.<sup>48</sup> Most of his principles are equally valid today. At present, Nepal needs to focus on economic diplomacy and remain politically neutral with two neighbors.

Foreign policy working through economic diplomacy with concentration on trade, aid, technology transfer, capital flows and official assistance must conform to the principles of nation building.<sup>49</sup> It will be in the benefit of Nepal for its development, taking the help of its neighbors to provide distributive justice to socially marginal groups while efficiently utilizing domestic and foreign resources. Gunanidhi Sharma suggests that the following points should be considered in the context of Nepal:<sup>50</sup>

- Rewriting of 1950 treaty with India,
- Review of overall foreign policy,
- Modernization of production relationships,
- Harnessing potential resources,
- Good governance and development of pro-people delivery systems while, taking into account even the backward areas.

Ivan Campbell wrote that Nepal is a market for Chinese goods in its own right, but more importantly it could also be a gateway to the markets of South Asia.<sup>51</sup> Campbell also includes the statement of a senior Chinese official that “developing Nepal as a transit hub between China and the larger sub-continent is a goal.”<sup>52</sup> Being a neighbor China will always have its security interests in Nepal. Moreover, Nepal’s role in all Tibetan issues is critical to China. Therefore, a stable Nepal is in China’s interest as far as Tibet is concerned,<sup>53</sup> while it also presents a more attractive opportunity for Chinese trade, investment and other forms of economic engagement.

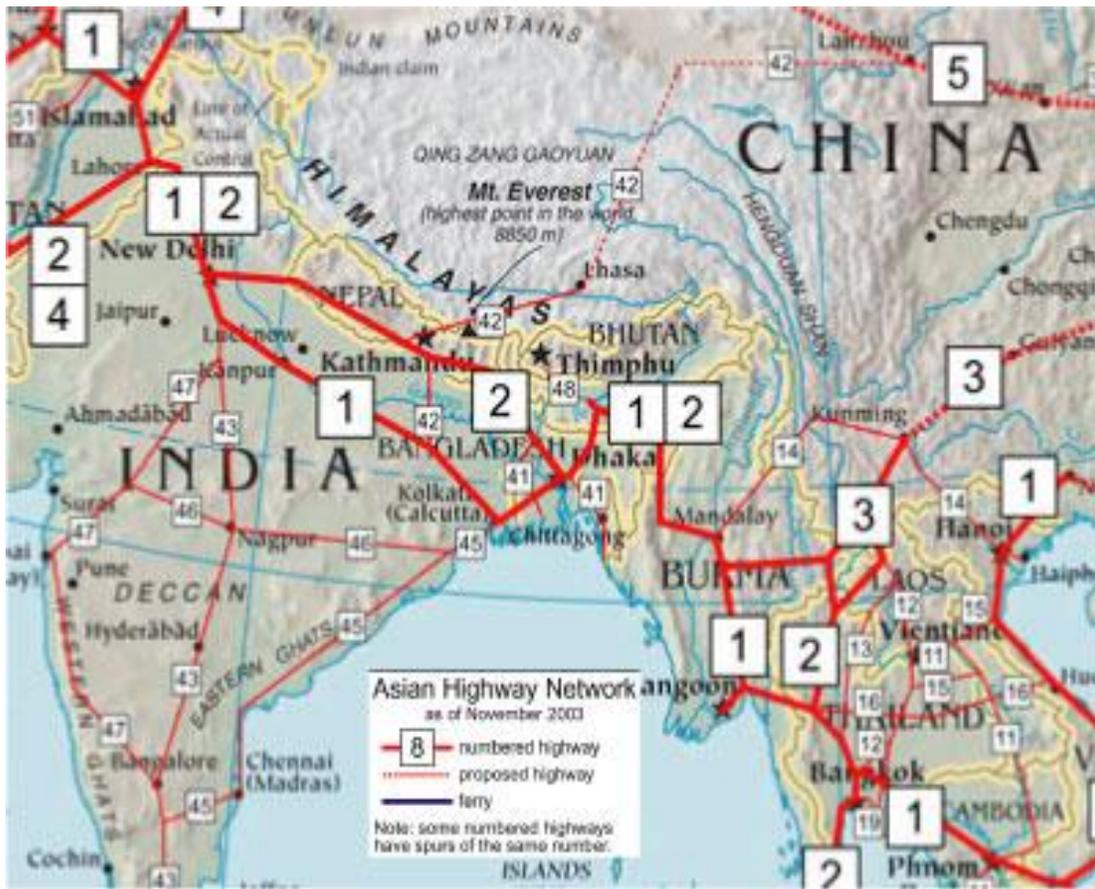
The geographic location of Nepal is important to both China and India. In the context of increasing bilateral trade between China and India, especially through the land route, Nepal acts as a transit point between the two nations. Bilateral trade between these two countries could also be diverted through Bhutan and/or Myanmar. But Nepal has the advantage over Bhutan and Myanmar because of the availability of existing routes and the proposed Asian Highway to connect China and India through Nepal. Therefore, Nepal has ample opportunities to become a bridge between the two fastest growing large economies in the world.

## Development of Nepalese Infrastructure

According to the last census of 2011 Nepal's population was 26.4 million and the latest records from 2012 show that GDP is \$ 37.74 billion, life expectancy 69.22 years and literacy 65.9 percent.<sup>54</sup> At present Nepal has about 28,000 km of road network out of which only 4,000 km is paved or blacktopped. Nepal has only 59 km of railway. Similarly, Nepal has about 83,000 MW of hydroelectricity potential, but only 556 MW (0.67% of potential) of electricity has been generated.<sup>55</sup> In the telecommunication sector, at present Nepal has about 16.5 million cell phones, 0.84 million land-line telephones and 0.18 million internet users.<sup>56</sup> These statistics show that Nepal has to improve its basic infrastructure a great deal. While Nepal can be a commercial hub between China and India, it needs to improve its infrastructure. The first and foremost step Nepal should take is to improve the existing road network. Secondly, Nepal should establish a railway link between Kathmandu-Khasa (border to Tibetan Autonomous Region of China) and Kathmandu-Birgunj (Indian border). Thirdly, Nepal needs to construct two additional international airports in Nijgarh and Lumbini. Fourthly, Nepal must exploit its hydroelectricity potential to the maximum. Fifthly, Nepal should focus on the tourism sector and develop Lumbini, the birthplace of Buddha, as a world "Peace City", like the Vatican and Mecca are to Christians and Muslims, respectively.<sup>57</sup>

The Asian Highway is a network of 141,000 km of standardized roadways that touches 32 Asian countries and links to Europe. Nepal is connected to India and China by Asian Highway 2 (AH2) and Asian Highway 42 (AH42), respectively (Map 3). The total length of these two sectors within Nepal is 1324 km. The National Highway from East to West (Kakarbhitta-Mahendranagar), namely East-West Highway (1027.6 km) is

a part of AH2. Another National Highway connecting Birgunj to Kodari (402.4 km) is a part of AH42 linking India to China.<sup>58</sup> The AH2 is 13,177 km-long, which starts from Denpasar, Indonesia to Khosravi, Iran whereas AH42 is 3,754 km-long connecting Lanzhou, China (on AH5) and Barhi, India (on AH1).<sup>59</sup> In order to improve its infrastructure, Nepal should accord priority to improve the Asian Highway portion through its own resources or with help from donors.



Map 3- Asian Highway Network

The government of Nepal plans to increase the strategic road network from the existing 8,000 km to 12,000 km by 2017.<sup>60</sup> But development of surface transport in Nepal faces various challenges mainly due to the rugged terrain, fragile geology, and numerous river crossings. Therefore, for the development of roads Nepal should also

focus on: a) the completion of the Mid-Hill Highway generally known as “Madhya Pahadi Rajmarg;” b) construction of an East-West Mountain Highway (Taplejung-Khadbari-Salleri-Charikot-Chautara-Dhunche-Chame-Jomsom-Dunai-Jumla-Gamgadhi-Simikot-Darchula); and c) open the border crossings with Tibet at Kimathanka, Kodari, Rasuwagadhi, Lomanthang and Hilsa to enhance trade with China. As of now only Kodari is operational and Rasuwagadhi is in progress; the rest of the three border crossings should also be connected by road as soon as possible to facilitate trade between the two countries.

A railway link between Kathmandu-Khasa and Kathmandu-Birgunj would facilitate trade with China and India. Nepal should also plan for a railway line adjacent to the East-West highway connecting Kakarvitta to Mahendranagar. Construction of two international airports in Lumbini and Nijgarh will not only facilitate international connection, but also help enhance trade and tourism.

The government of Nepal has an objective to generate 25,000 MW of hydropower by 2030.<sup>61</sup> To fulfill its target, Nepal must garner investment from foreign countries or international agencies, especially from China and India, and then make arrangements with China and India to sell the extra electricity (that exceeds the domestic demand).

Tourism in Nepal is the largest industry and the major source of foreign exchange and revenue. Nepal is a famous tourist destination, whether it is for leisure, vacation, adventure, trekking, or cultural tour. It is not just fascinating but incredible and unmatched by the rest of the world.<sup>62</sup> The total number of tourists to Nepal by air reached 598,204 in 2012, which is almost 10 percent more than in 2011.<sup>63</sup> If Nepal

could focus more on the tourism industry and consider even opening up for more religious tourism, there are high chances of a dramatic increase in the number of tourists.

### Conclusion

Chinese foreign policy principles are formally guided by improving relations with the developed countries, strengthening friendly relations with neighboring countries, and enhancing cooperation with the Third World. The U.S.-Sino-Indian triangle seems to be the most important strategic relationship at present. China emerged as the largest trading partner of India, and Nepal can take advantage of the increasing trade between China and India.

The Beijing-Islamabad “special relationship” is a part of China’s grand strategy that molds the South Asian security environment. Nearly 70 percent of Pakistani military hardware originates from China.<sup>64</sup> Additionally, China maintains good relationships with other South Asian nations, namely Bangladesh, Bhutan, Maldives, Nepal and Sri Lanka. While India feels that China aims at deliberate encirclement of India, the Chinese have significant economic and strategic stakes in the Indian Ocean and are concerned about the economic lifelines at sea. China and India are competing for resources, control of sea lanes, power and influence in the regional and global level.

Nepal has been a melting pot for Hinduism and Buddhism, where both have co-existed harmoniously. Lumbini, the birth place of Gautama Buddha, could be developed into a world “Peace City,” which will also enhance tourism in Nepal. Nepal should also focus on development of its huge hydro-electricity potential.

India is the most significant external economic actor in Nepal; however, China has increased the level of its engagement with Nepal since 2006, with a marked increase from 2011.<sup>65</sup> It is believed that the ongoing Lhasa-Khasa rail link will be a strategic gain in terms of trade and geo-politics in the region. Nepal could also potentially become a land gateway for Chinese trade and commerce with South Asia.

Bilateral trade between China and India is expected to rise to \$100 billion by 2015.<sup>66</sup> Increased volume of trade and Nepal's geographic location has increased its bridging role between China and India, two of the largest economies of the world. However, Nepal has much to do to develop its infrastructure to enhance its capacity for handling large trade between its northern and southern neighbors. Nepal can benefit from its geostrategic position and facilitate economic cooperation between the emerging powers.

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