

## Navigating the Complexities of the Belt and Road Initiative (BRI) and Millennium Challenge Corporation (MCC) in Nepal

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### Abstract

This research explores the intricate dynamics surrounding Nepal's involvement in the Belt and Road Initiative (BRI) and the Millennium Challenge Corporation (MCC), positioned amidst the strategic interests of China and the United States. Nepal's historical foreign policy, characterized by selective isolationism and international engagement, has been shaped by its geostrategic location between the two global powers, often likened to a "yam between two boulders." The BRI, launched by China in 2013, aims to bolster connectivity and infrastructure across Asia, Africa, and Europe, influencing Nepal through substantial investments and geopolitical alignments. Conversely, the MCC, initiated by the U.S. in 2017, seeks to enhance Nepal's economic stability and development, albeit amid perceptions of strategic rivalry with China's regional influence. This study employs qualitative analysis to evaluate the implications of these initiatives on Nepal's sovereignty, stability, and strategic positioning. It addresses the strategic challenges of managing Nepal's relationships with China, India, and the U.S. while maintaining its policy of non-alignment, offering insights into navigating the complexities of international collaborations in a rapidly evolving geopolitical landscape.

*Keywords:* BRI, MCC, debt-trap diplomacy, American Strategy, sovereignty

### Introduction

Nepal occupies a strategic position in South Asia, situated between the emerging powers of China and India. This geostrategic location has significantly influenced Nepal's foreign policy, often shaped by the geopolitical dynamics between its two giant neighbors. Historically, King Prithvi Narayan Shah, Nepal's founder, aptly described the nation as a "yam between two boulders," emphasizing the geopolitical pressures on its foreign policy (Bhattarai, 2017).

Since its unification in 1768, Nepal has maintained sovereignty through a selective isolationist yet actively internationalist foreign policy (Simkhada, 2022). The post-World War II era, particularly after 1945, saw the rise of the Non-Aligned Movement (NAM), which was crucial for nations like Nepal navigating a bipolar world. Although NAM's political relevance has diminished since the 1990s, Nepal continues to recognize its value in maintaining a balanced foreign policy stance (Ghimire, 2023).

The Millennium Challenge Corporation (MCC) agreement has sparked geopolitical tensions between China and the US, highlighting Nepal's delicate position. China's strategic efforts focus on enhancing its soft power and promoting the "China development model" as an alternative to Western values (Yagci, 2018). China has been a consistent development partner, contributing to Nepal's infrastructure, industrialization, and human resources development based on the Five Principles of Peaceful Co-existence.

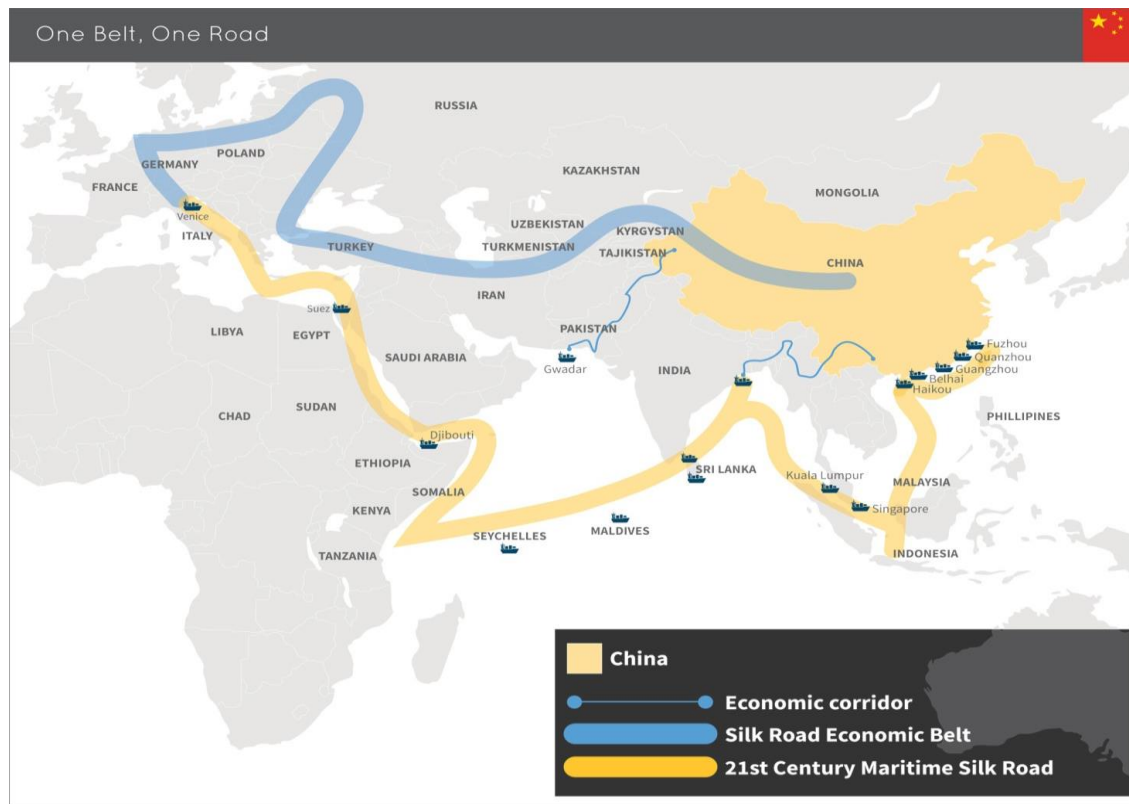
In 2013, China launched the Belt and Road Initiative (BRI), a vast infrastructure project connecting Asia, Africa, and Europe, which includes significant investments in Nepal (Yagci, 2018). Conversely, the US, which established diplomatic ties with Nepal in 1947, has been a key development partner since the early 1950s, focusing on peace, democracy, and economic growth (Lamichhane, 2022).

The international system has been characterized by US unipolarity for nearly 30 years, raising questions about future power dynamics as the US and China enter a new phase of rivalry. This "New Cold War" is marked by deep mutual mistrust despite economic interdependence (Smith et al., 2012; Kausikan, 2021).

Nepal's role as a buffer state between China and India has necessitated a careful balancing act. Recent US engagement in Nepal, through initiatives like the MCC, is perceived by China as a challenge to its regional influence, complicating the geopolitical landscape (Asia Society Policy Institute, 2023). Nepal continues to navigate this complex environment, balancing its relationships with China, India, and the US amid growing strategic tensions.

The Belt and Road Initiative (BRI) represents a significant milestone in the bilateral relations between China and Nepal. The implications of the BRI are substantial for Nepal and warrant extensive investigation, particularly as they are expected to influence the trilateral dynamics between Nepal, India, and China. China's application of soft power in Nepal is increasingly apparent, though it has focused more on political and geopolitical dimensions than cultural aspects. Conversely, the Millennium Challenge Corporation (MCC) is perceived as a strategic move to counter China's regional hegemony.

The heightened presence of both China and the United States in Nepal is evident, with direct interactions resulting from China's stance on the MCC and US efforts to secure parliamentary approval for the MCC Compact Agreement in Nepal. The intensifying rivalry between these two nations is manifesting within Nepal, reflecting broader international tensions. China's skepticism towards the Nepali government and its political parties has grown due to the lack of progress on BRI projects. China suspects that the geopolitical environment may have hindered the advancement of these projects, despite the agreement being in place for five years.

**Figure 1***BRI and Its Circle*

(Source: World Economic Forum)

Nepal's relationships with China and the United States have been characterized by mutual support and cooperation in socio-economic development, establishing both nations as close friends and development partners. However, the confrontation between China and the US over the MCC ratification presents a concerning development for Nepal. Analysts emphasize that the strategic competition between these global powers in Nepal should not be underestimated.

The MCC, being a grant-based initiative, does not pose an economic burden. In contrast, the BRI's funding model, which is not grant-based, raises concerns. Analysts suggest that converting BRI projects to grant-based funding would facilitate their implementation, given Nepal's limited internal resources for such large-scale infrastructure projects. Achieving a mutually beneficial agreement on the implementation modality between China and Nepal would simplify project execution.

Nepal's foreign policy, rooted in the principle of non-alignment, has enabled it to navigate the complex geopolitical aspirations and interests of its neighboring countries. Aligning with any single power could be detrimental to Nepal, considering its geopolitical vulnerabilities and limited capacity to manage potential repercussions. As India and China rise as 21st-century

powers, Nepal has the opportunity to enhance its international image by positioning itself not as a landlocked, but a land-linked state between these economic giants.

For a small state like Nepal, maintaining a delicate balance in its relations with India, China, and the US is crucial for promoting and protecting its national interests. The primary challenge lies in whether Nepal can manage its geopolitical vulnerabilities while adhering to non-alignment principles amidst involvement in two major international projects. This challenge is exacerbated by the increasing division of opinions on whether to strengthen ties with China to counterbalance its dominance or to align with the US and Western allies for further economic support.

### Objectives of the Study

This study aims to provide a thorough evaluation of the topic "BRI and MCC: The Labyrinth for Nepal" by pursuing the following objectives:

- To assess the understanding of the two major projects, namely the Belt and Road Initiative (BRI) and the Millennium Challenge Corporation (MCC).
- To analyze various case studies related to the BRI and MCC.
- To examine the potential implications of Nepal's involvement in the BRI and MCC.
- To explore strategies for Nepal to manage the associated challenges.

### Literature Review

The Belt and Road Initiative (BRI) is emerging as a global phenomenon, potentially influencing numerous countries, including Nepal. This article examines the repercussions of the BRI in Nepal, arguing that China's sustained emphasis on capitalist principles may yield diverse effects, from highly favorable to markedly adverse outcomes. Concurrently, the US-China rivalry could have dual impacts on Nepal, enhancing its negotiating leverage while risking its stability and sovereignty. This rivalry might prompt China to perceive Nepal as strategically crucial, resulting in significant investments (Prasai, 2023).

Nepali perceptions of the Indo-Pacific Strategy (IPS) as a countermeasure to China's BRI have intensified since the U.S. Department of Defense released the Indo-Pacific Strategy Report in June 2019. Various communist factions in Nepal fear that aligning with the IPS could strain relations with China, viewing the IPS as a military strategy in contrast to the BRI's focus on connectivity and infrastructure. Rupak Sapkota, deputy executive director at the Institute of Foreign Affairs (IFA), remarked that the IPS's military engagement is incomparable to the BRI, although future security components of the BRI cannot be entirely ruled out (Sharma, 2022).

In "South Asia and China: Engagement in the Twenty-First Century," Kosh Raj Koirala discusses China's growing influence in India's neighboring countries through major infrastructure projects and educational scholarships, portraying China as an alternative to counterbalance India's perceived hegemonic behavior. This dynamic offers smaller South Asian states a strategic equilibrium to address their security concerns (Koirala, 2021).

The strategic and economic interests of China and the USA in Nepal have heightened their rivalry (Wagle, 2021). The MCC compact, viewed by many as an economic initiative with a strategic agenda to counterbalance China, is highly contentious in Nepal (Chand, 2021). On September 14, 2017, the USA signed the MCC compact with Nepal, four months after Nepal joined the BRI. The MCC website describes the agency as an innovative U.S. foreign assistance entity combating global poverty, while critics see it as part of the IPS aimed at addressing common security challenges (MCC website).

The Indo-Pacific Strategy, introduced by the United States to exclude China, has been criticized by Russian Foreign Minister Sergey Lavrov, who suggested that its renaming from Asia-Pacific was to marginalize China (Sharma, 2020). The MCC is included in the U.S. Indo-Pacific Strategy, with substantial funding dedicated to supporting this initiative (Department of Defense, 2019).

The BRI promises enhanced connectivity between China and Nepal, fostering socio-economic growth and tourism, and creating unprecedented opportunities for trade and commerce. Current development alignments between China and Nepal focus on infrastructure projects, such as highways, hydropower, and border facilities, alongside discussions on extending the Tibetan railway into Nepal and India (Giri, 2019).

However, the BRI has faced criticism for promoting authoritarian regimes and lacking transparency (Kuo, 2019). Despite these concerns, many poorer nations have embraced BRI funding. Critics have highlighted issues such as "debt-trap diplomacy," where China is accused of burdening borrowing countries with unmanageable debts (Himmer & Rod, 2023).

China's strategic victory in South Asia with Nepal's 2017 BRI accession is now seen as faltering, with growing opposition to the initiative and significant geopolitical setbacks, such as Nepal's parliamentary approval of the MCC compact (Jha, 2022). This shift underscores China's limitations as an economic superpower.

This study retells various accounts of China's international engagements, from Angola to Venezuela, illustrating the broader implications of China's global strategy (Brautigam, 2019). While the term "imperialism" is avoided in Western discourse regarding international finance, China is often depicted as an imperialist threat, particularly by Western media (Andreani, Herrera & Long, 2021).

Despite extensive studies on the Belt and Road Initiative (BRI) and the Millennium Challenge Corporation (MCC) and their respective impacts on Nepal, there remains a significant research gap in understanding the nuanced, long-term socio-political and economic implications of these mega-projects on Nepal's geopolitical positioning. Specifically, existing literature lacks comprehensive analyses on how Nepal can strategically manage the competing influences of China and the United States while maintaining its policy of non-alignment. Furthermore, there is a need for more empirical studies that explore the local perceptions and responses to these projects, as well as the potential for these initiatives to either enhance or undermine Nepal's sovereignty and stability. Addressing these gaps is crucial for formulating effective strategies that can maximize the benefits of international collaborations while mitigating associated risks.

## Methodology

This research employs qualitative data analysis, utilizing both content analysis and doctrinal research methods as appropriate. The research design is analytical, descriptive, critical, and historical. The study primarily relies on secondary data sources. Information and insights have been gathered from a range of published research works, authoritative books, journals, periodic theses, research reports, and relevant websites available in various libraries.

The concepts examined in this study are analyzed through the lens of two major schools of thought in international relations: Realism and Liberalism. Additionally, the involvement of the two major projects, BRI and MCC, is scrutinized with the understanding that improper management could lead to significant adverse consequences for Nepal.

## Limitations of the Study

This research addresses a broad and complex topic. Therefore, the focus will be specifically on the implications of the BRI and MCC for Nepal.

## BRI and MCC: Labyrinth for Nepal

### China's Belt and Road Initiative

In September 2013, Chinese President Xi Jinping, in a speech at Nazarbayev University in Kazakhstan, invoked the historical Silk Road to introduce the Belt and Road Initiative (BRI). He highlighted the deep historical and cultural ties between China and Kazakhstan, emphasizing the symbolic importance of the Silk Road in fostering connections. The BRI, inspired by this ancient trade route, aims to enhance global connectivity through extensive investments in infrastructure, such as ports, railways, and telecommunications networks, thereby promoting regional integration, trade, and economic growth (Ministry of Foreign Affairs of the People's Republic of China).

Since its inception, the BRI has grown to include 155 countries, encompassing nearly 75% of the world's population and accounting for more than half of global GDP (Nedopil, 2023). Despite facing criticism for potential debt-trap diplomacy and transparency issues, the initiative remains a significant tool for China's international economic strategy (Kuo, 2019). Recent trends indicate a shift towards high-quality investments, emphasizing project finance, risk mitigation, and green finance.

### Millennium Challenge Corporation (MCC)

The Millennium Challenge Corporation (MCC) was established in 2004 to administer U.S. foreign aid with the goal of reducing poverty through economic growth in low- and lower-middle-income countries committed to good governance (Tiwari, 2020). Proposed by President George W. Bush in response to the increasing threat of global terrorism post-9/11, the MCC operates independently from traditional aid agencies like USAID.

The MCC provides grants based on competitive selection criteria, ensuring that recipient countries adhere to sound economic policies and demonstrate potential for growth. As of 2022, the United States' official development assistance totaled USD 55.3 billion, reflecting its commitment to global poverty alleviation and support for strategic initiatives (OECD, 2023). MCC-funded projects address critical issues such as electricity supply, clean drinking water, and transportation infrastructure, significantly improving living standards in developing countries

### **Reasons Behind the Dispute Over MCC in Nepal**

In July last year, Finance Minister Yubaraj Khatiwada registered the Millennium Challenge Corporation (MCC) compact in Nepal's federal parliament for ratification. However, it has not been presented for approval. A faction within the Nepal Communist Party (NCP), led by Chief Whip Dev Gurung, had been lobbying former Speaker Krishna Bahadur Mahara to delay its ratification. Despite claims from Prime Minister Oli and his ministers that the compact would be ratified in the ongoing winter session of Parliament, it remains in limbo. Oli, in an interview with Kantipur Daily on October 19, attributed the delay to Mahara (Ghimire, 2022).

The compact's controversy intensified following comments from David J. Ranz, Assistant Secretary for South Asia at the U.S. State Department, during his visit to Nepal in May last year, linking the MCC to the Indo-Pacific Strategy. This sparked demands from dissenting leaders within the ruling party for clarification on whether the MCC was part of the U.S. strategy. Contradictory statements from U.S. officials and Nepalese politicians further complicated the situation, with allegations that Foreign Minister Pradeep Gyawali had misled them about the MCC's association with the Indo-Pacific Strategy (Ghimire, 2022).

The opposition to the MCC in Nepal has deep historical and political roots. The left-leaning political elite in Nepal has long been skeptical of U.S. intentions, viewing them through the lens of imperialist interventions in smaller countries. This skepticism has been exacerbated by Nepal's expanding ties with China and the broader U.S.-China strategic rivalry. The MCC is perceived by some as a component of the U.S.'s broader strategy to counter China's influence in the region. These geopolitical dynamics have been further inflamed by Chinese disinformation efforts and diplomatic maneuvers, which have fostered a climate of suspicion and resistance towards the MCC in Nepal (Ghambhir, 2022).

Nepal's fragile political landscape and nascent democratic institutions have heightened fears of external influence. China has capitalized on these fears, portraying the MCC as a threat to Nepalese sovereignty and stirring opposition to the \$500 million grant-based program. Despite U.S. clarifications that the MCC is purely developmental and not linked to military objectives, these assurances have done little to quell the controversy (MCC Website).

### **Strategic Implications for China**

Nepal's ratification of the MCC with a two-thirds parliamentary majority represents a significant political and strategic setback for China. Despite Nepal's 2017 alignment with China's Belt and Road Initiative (BRI), progress on BRI projects has stalled, and resistance has grown.

China's influence in Nepal has been challenged by the ratification of the MCC, signaling that China's economic and political strategies are not invincible (Jha, 2022).

China's deep reservations about U.S. involvement in Nepal have been evident. Reports suggest that China actively sought to undermine the MCC, with Chinese officials, including Ambassador Hou Yanqi, engaging in discussions with various parties to this end. The Chinese disinformation campaign on social media further highlighted China's efforts to influence Nepalese public opinion and parliamentary decision-making (Kumar, 2021). Despite these efforts, four of the five largest political parties in Nepal's parliament, including the CPN-UML, voted to ratify the MCC, indicating a significant shift in Nepal's political dynamics (Biswas & Baral, 2022).

China interprets the MCC's ratification as indicative of intense political and economic competition in Nepal, suggesting similar patterns may emerge in other South Asian countries. This development underscores the complex interplay of local politics and global strategic rivalries influencing Nepal's domestic and foreign policy decisions (Dahal, 2022).

### **BRI and Nepal**

Nepal is significantly smaller than the United States, China, and India, but its strategic importance to these major powers is disproportionately high (Agrawal & Upadhaya, 2006). The Belt and Road Initiative (BRI), launched by China in 2013, aims to enhance investment and economic activity through the 21st Century Maritime Silk Road and the New Silk Road Economic Belt (The Economic Intelligence Unit, 2015). Nepal ratified the BRI on May 12, 2017, solidifying its commitment to this global initiative (The Himalayan Times, 2017).

In May 2017, Nepal and China signed a Memorandum of Understanding (MoU) to promote cooperation in policy exchanges, infrastructure connectivity, trade connectivity, financial integration, and people-to-people connectivity. The Nepalese government established two committees, chaired by the finance and foreign secretaries, to identify suitable projects for collaboration with China. Initially, 35 projects were selected for development under the BRI. However, after prolonged discussions, China requested Nepal to narrow the list to ten projects, resulting in a final list of nine projects to receive funding under the BRI:

President Bidya Devi Bhandari represented Nepal at the Second Conference on International Cooperation in Beijing in April 2019, alongside 38 other heads of state. The BRI, initiated to fund global infrastructure projects, leverages China's substantial reserves of USD 3.21 trillion to extend its global influence (Jha, 2019).

Shortly after ratifying the BRI, Nepal signed an agreement with the United States on September 14, 2017, for the Millennium Challenge Corporation (MCC) project. This project focuses on constructing a 400 KV high-voltage transmission line and upgrading roads (My Republica, 2022). The One Belt One Road (OBOR) International Trade and Investment Platform identified infrastructure development, commercial farming, energy, tourism, and international trade as key sectors for collaboration in Nepal (My Republica, 2018).



Under the BRI framework, China proposed concessional funding of up to \$1 billion at a 3 percent interest rate to Nepal (Wagle, 2018). Specific projects include a \$130 million investment in a cement plant, a 164 MW hydropower facility at Kaligandaki Gorge, a 40 MW plant at Siuri Nyadi, a 75 MW plant at Trishuli Galchhi, and a 600 MW project at Marsyangdi Cascade. Additionally, an MoU was signed to develop the Eastern Tarai Irrigation System and a \$46 million highland food project (Wadlow, 2018).

Nepal's relevant ministries are tasked with developing finance and investment models for these projects. Estimates suggest Nepal would need to secure \$10 billion to fund these initiatives (Giri, 2018). To facilitate these projects, China has established a Commercial Counselor Office in Kathmandu to expedite work on Chinese-supported projects in Nepal.

### **Debt-trap Diplomacy**

Debt-trap diplomacy refers to a strategic practice in international finance where a creditor nation or institution extends loans to a borrower country, often with the primary aim of enhancing political influence. This practice involves offering excessive credit to the debtor, which can lead to economic and political leverage over the borrower when it struggles to meet repayment obligations. The terms and conditions of these loans are frequently not disclosed publicly. This global infrastructure development strategy, launched in 2013, aims to bolster China's economic presence worldwide. Despite its role in facilitating easier access to investment for developing nations, the BRI has faced substantial criticism for fostering relationships with autocratic regimes and non-transparent lending practices.

Specific cases, such as Sri Lanka's Hambantota port, illustrate instances where debtor nations, unable to repay Chinese loans, have had to cede control of critical assets to Chinese entities. Similarly, Pakistan's mounting debt to China under the China-Pakistan Economic Corridor (CPEC) and other infrastructure projects highlights concerns over sovereignty and economic dependency. These examples underscore broader criticisms of China's debt diplomacy, suggesting potential risks to borrower nations' sovereignty and economic stability.

### **MCC and Criticism over Clauses**

Critics of the MCC compact highlight several contentious clauses that raise concerns about its implications for Nepal's sovereignty and legal framework. Section 6.4 of the agreement explicitly asserts its status as an international treaty governed by international law, a provision that diverges from Nepal's domestic legal procedures outlined in Section 4 of the Nepal Treaty Act, 1990, which mandates parliamentary approval for such agreements to become binding international law. Unlike China's Belt and Road Initiative (BRI), which operates outside conventional international legal frameworks, the MCC compact adheres to the Vienna Convention on the Law of Treaties (1969), emphasizing legal accountability and oversight. Critics argue that while international agreements are expected to be conducted in good faith by all parties, Nepal's acceptance of MCC funding, coupled with provisions superseding domestic laws per Section 9 of the Nepal Treaty Act, could potentially undermine national sovereignty and regulatory autonomy. Despite assurances that MCC funding aims to foster political stability and economic growth in Nepal, concerns persist over the agreement's perceived infringement on local laws and governance structures.

### Conclusion

Nepal faces complex geopolitical challenges amidst its involvement in significant international aid projects like the controversial transmission line initiative. As this initiative progresses, issues of implementation, financing, and accountability have intensified, complicating Nepal's internal dynamics and its role in the Indo-Pacific strategy. The country must adeptly balance relations with major powers like India, China, and the United States, navigating their competing strategic interests while safeguarding national sovereignty. Debates over initiatives such as the Millennium Challenge Corporation (MCC) compact underscore Nepal's dilemma, caught between economic opportunities and concerns over sovereignty amid global power rivalry. Strategic engagement with both the U.S. and China is crucial for Nepal to extract economic and political benefits while avoiding entanglement in broader geopolitical conflicts, necessitating a nuanced approach to international relations and domestic policy formulation.

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