Navigating a Multipolar World:

Examining Small State Strategies in South Asia

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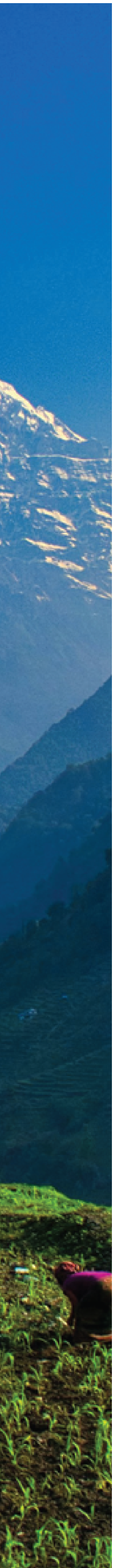

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Preface

In today's changing global order, the growing weight of geopolitical rivalries is falling most heavily on small states. In South Asia, the competition between China and India, layered with the shifting priorities of the United States and others, has reshaped the policy space available to countries like Nepal, Sri Lanka, and Bangladesh. For these states, strategic alignment is no longer a question of loyalty or ideology, but of survival and statecraft.

This volume explores how small states in South Asia are responding to intensified regional and global power rivalries. At its core lies a deceptively simple question: how do small states exercise agency in an environment increasingly defined by asymmetry?

Authors set out to answer this question by going beyond the well-trodden international relations theories of balancing, bandwagoning, and hedging. Instead, they examined the messier reality of how domestic political economy, elite incentives, and institutional fragility shape foreign policy decisions. Through in-depth case studies, the research shows that small states rarely behave predictably, and even less often in line with theoretical expectations. What emerges instead is a dynamic picture of opportunism, constraint, and strategic improvisation.

This work draws on the contributions of local experts from each country who brought deep contextual insight to their analyses. They have examined how infrastructure investments, development finance, and diplomatic postures become instruments of engagement and leverage for small states navigating large power interests. From the Trincomalee oil farm in Sri Lanka to Nepal's China transit agreement to Bangladesh's handling of the Rohingya crisis, these case studies reveal how small states both shape and are shaped by the geopolitical currents around them.

The synthesis paper that anchors this volume introduces a framework for interpreting these behaviors, rooted in political economy analysis and grounded in the day-to-day realities of policymaking in complex, often volatile, contexts. Rather than prescribing a single strategy or ideal type, the analysis maps the choices, trade-offs, and consequences small states face as they maneuver between giants.

This project has also been an exercise in collaborative inquiry among experts, reflecting a commitment to locally led research, regional knowledge sharing, and evidence-based policy engagement. Sincere thanks to the country experts who authored the case studies and to Sagar Prasai and Mandakini Surie, whose leadership and analysis shaped the synthesis and conceptual framing of this volume.

While this publication includes case studies from Nepal, Bangladesh, and Sri Lanka, the broader research also drew on insights from Bhutan and the Maldives. Although those country papers are not published here due to contextual sensitivities, they were critical in developing the analytical framework and deepening our understanding of the diverse strategies employed by small South Asian states.

Navigating Geopolitical Rivalry in South Asia:

Understanding Small State Strategies

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Abstract

In an increasingly multipolar world, geopolitical competition among global and regional powers is likely to intensify and become less predictable. Stable alliances and partnerships will be difficult to negotiate and sustain. This development puts small states in a precarious position. Their need to balance shifting alliances, protect economic and security interests, and maintain national sovereignty can become more challenging. This paper examines the pressures that South Asian small states are facing from a changing world order and proposes a conceptual framework that may enable us to better understand the variety of strategies and responses that small states have adopted to navigate the evolving geopolitical context.

Introduction

The rapid rise of China, a deepening rift in the U.S.-Russia and U.S.-China relationship, ongoing conflicts in Europe and the Middle East, and the emergence of progressively more assertive regional powers are changing the unipolar geopolitics of the 1990s at a fundamental level. The re-election of U.S. President Donald Trump has further accelerated a shift toward a new era of geopolitics characterized by inward-looking assertive nationalism and economic protectionism. In a recently televised speech, Singapore's prime minister remarked that the world is "entering a new phase in global affairs—one that is more arbitrary, protectionist and dangerous," emphasizing that it is "uncertain, unsettled, and increasingly unstable."[1]

Within days of assuming office, President Trump issued a series of executive orders, resulting in the shutdown of USAID and the imposition of steep tariffs on many countries. As world leaders contend with these developments, it is clear that a new world order is emerging—one where the conventional rules of statecraft and the international rules-based order that emerged after World War II are being tested and tried, unlike ever before.

While the contours of this new world order and its key players are still taking shape, certain elements are coming into focus. There is a clear shift from an era of geopolitics dominated by the United States and its allies to a new, multipolar, and increasingly fragmented world. Competing global and regional powers are vying for influence in strategic areas and regional blocs. The gradual decline and breakdown of multilateralism has led to a shift toward unilateralism and a growing loss of faith in the legitimacy of multilateral institutions such as the United Nations, the World Trade Organization, and the World Health Organization.

For smaller countries, particularly in regions with active conflict or spiraling geopolitical competition among global and regional powers, the state of flux in the international world order can become tricky to navigate. Smaller countries in the South China Sea and continental Africa are forced to balance competing U.S., Chinese, and regional power interests. Similarly, in the Middle East, some countries have had a tougher time maintaining the domestic legitimacy of the state while balancing multiple external pressures, often sliding into instability and civil war. At the same time, the sudden withdrawal of U.S. development and humanitarian assistance has had a tremendous impact on countries around the globe but especially in Central and East Asia, West Africa, Central Europe, and the Americas—raising questions about the future of development cooperation as well as the commitment of the United States and other countries to the Sustainable Development Goals and the Paris Agreement on climate change. Signs of these geopolitical shifts are becoming tangible in South Asia.

Widely regarded as one of the least integrated regions in the world due to a legacy of colonialism and partition, South Asian politics and economics have traditionally been dominated by India, which historically regarded the entire region as its uncontested sphere of influence. As recently as two decades ago, India's economic, cultural, and strategic dominance in South Asia went largely unchallenged, even by China—which had made few inroads in the region aside from Pakistan. However, in recent years, China's expanding footprint in South Asia through the Belt and Road Initiative has challenged India's predominance in the region and opened a new chapter in a strategic rivalry that spans several decades.[2]

Amidst the current flux in international geopolitics and intensifying rivalry between India and China in South Asia, for small countries in the region—Bangladesh, Bhutan, Maldives, Nepal, and Sri Lanka—the stakes are increasingly higher as they see pressure to favor one power over another on a range of issues including trade, infrastructure development, connectivity, development assistance and finance, commercial contracts, development of strategic assets, and procurement of military hardware. Conversely, and as is often seen in such situations, they may see the opportunity to play one or more powers against the others and try to draw as many concessions as possible from all of them. In most cases, however, small state strategies for dealing with large powers tend to fall somewhere between openly favoring one side and skillfully playing both sides against each other. However, these maneuvers can often be quite tricky.

This paper draws on existing literature and research on small state strategies globally and a set of 15 case studies from five countries—Bangladesh, Bhutan, Nepal, the Maldives, and Sri Lanka—to articulate an analytical framework to understand how small states are responding to growing geopolitical rivalry in South Asia. Authored by researchers from each of these countries, the case studies examine specific instances where small states have navigated big power rivalry between India, China, the United States, and other powers in the region. Examples include the Rohingya crisis in Bangladesh, the India-Bhutan Agreement on Trade, Commerce, and Transit, the China-Nepal Transit Agreement of 2016, the China-Maldives Friendship Bridge and the Greater Male Connectivity Project in the Maldives, and the Mattala Rajapaksa International Airport and Lotus Tower projects in Sri Lanka.

It is important to recognize that the behavior of small states can be inconsistent across different situations. In many cases, their policy positions are influenced by narrow political and economic interests of the ruling elites rather than by broader national goals. In other instances, their strategies may reflect a combination of both. These strategies could also drive small states to lean toward one regional power in one instance and pivot toward balancing key powers in another. Consequently, rather than pursuing a singular theoretical explanation of how small states behave, this paper has resorted to categorizing small state strategies and actions through a comparative analysis of the different case studies. The conceptual framework we have arrived at aims to identify the key drivers of small state behavior and to investigate the goals and approaches employed to navigate the challenges posed by asymmetric power relations while protecting their autonomy and engaging with larger powers on both regional and global levels.

Mapping South Asia's Shifting Geopolitics

Geopolitics in South Asia is deeply influenced by the region's rich civilizational history and culture, shared experiences of colonialism and partition, post-independence state formation, and democratization. The region remains one of the least integrated areas in the world, characterized by limited infrastructure connectivity, trade, markets, and people-to-people exchanges. Cross-border mobility and economic cooperation remain particularly constrained, shaped by the region's complex and often contentious political history. The enduring legacy of colonialism, the trauma of partition, unsettled borders, and festering bilateral and multilateral conflicts—particularly those involving India, Pakistan, China, and Bangladesh—have significantly hindered regionalism. Institutional mechanisms for cooperation have also remained weak or ineffectual. The South Asian Association for Regional Cooperation has been largely dormant since 2016, and sub-regional platforms such as the Bangladesh-Bhutan-India-Nepal initiative and the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation have achieved only limited traction.[3]

As the dominant economy and arguably most stable democracy in the region, India has significantly shaped and framed the narrative around South Asian regionalism. Often described as the "Big Brother" in the region by its smaller neighbors, India has viewed South Asian regionalism through the prism of securing its strategic interests. For decades, South Asian geopolitics has been heavily influenced by the rivalry between India and Pakistan. The two nuclear powers have fought four wars, experienced numerous border skirmishes, and remain embroiled in the long-standing territorial dispute over Kashmir. The intermittent conflict has recently intensified following a terror attack on civilians in Indian-administered Kashmir on April 22, 2025.

The Emergence of India-China Competition

By far, the most significant driver of geopolitics in the region in the last two decades has been the rise of China. The India-China bilateral relationship has been marked by strategic competition, cooperation, and sporadic conflict. The two fought a border war in 1962 and have unresolved territorial disputes that frequently derail diplomatic ties. China's economic growth and expanding footprint—in South Asia and the Indian Ocean region—represent a geostrategic and security challenge for India.

India's foreign policy strategy seeks to balance rather than contain China. China's expanding footprint in South Asia through the Belt and Road Initiative (BRI) and other investments has caused India to reassess its strategic interests in the region.[4] Since 2014, under the leadership of Prime Minister Narendra Modi, India has made a concerted effort to align its foreign policy and international cooperation to expand the country's influence and counterbalance China in key geographies. This is reflected in foreign policy directives such as "Neighborhood First"—seeking deeper ties in South Asia; "Act East"—focused on ASEAN; and through the "Sagar—Security and Growth for All in the Region"—focused on maritime cooperation in the Indian Ocean. India's engagement with the Quad and increase in bilateral and trilateral engagements with the United States, Japan, Australia, and other allies in the Indo-Pacific region reflect India's evolving need to reorient strategic alliances.

Despite India's efforts to strengthen its influence, China's trade and economic relations with most South Asian countries have been steadily growing. Total trade between China and South Asian countries increased from under USD 100 billion in 2013 to USD 197.4 billion in 2022, reflecting an average annual growth rate of 8.3 per cent, according to China's Ministry of Commerce.[5] While the bulk of India's development cooperation investment is to countries in the region, in terms of volume, it is far outstripped by Chinese development assistance and investment through initiatives such as BRI and other in-country infrastructure investments such as the Trans-Himalayan Corridor in Nepal, Hambantota Port in Sri Lanka, China-Pakistan Economic Corridor and Gwadar Port in Pakistan, and investments in the Maldives and Bhutan.[6] However, the recent economic crises in Pakistan and Sri Lanka and fears about growing economic interdependence with China have created strategic opportunities for India to wield its political and economic influence amongst smaller countries in the region. These shifting economic and geopolitical ties have given China renewed confidence and India a new challenge and opportunity in reasserting its influence in South Asia.

For smaller nation states such as Bangladesh, Bhutan, Nepal, Maldives, and Sri Lanka, the India-China rivalry has created new opportunities to play one against the other while extracting economic benefits and investments.[7] At the same time, managing the balancing act between two regional powers also has its risks, particularly when domestic politics gets embroiled in geopolitical polarization, such as in the Maldives or for example in in Bangladesh where one party was publicly considered as pro-India, the other was considered pro-China. On matters of trade, preferential bilateral agreements, investments, large construction contracts, and defense procurements, smaller countries often get hamstrung by the competing influences of the two regional powers and the interplay with their own domestic and foreign policy concerns.

Recent Political Developments in South Asia

South Asia is more fractious and unstable today than it has been for several decades. The political and economic situation in Pakistan has deteriorated significantly in recent months. The rapid depreciation of the Pakistani rupee, along with dwindling foreign exchange reserves, has left the country struggling to import essential goods. The situation remains unstable with rising public discontent over the economic situation and resurgent Islamic militancy. India, on the other hand, must contend with increasingly tense and volatile borders with China in Ladakh and Pakistan in Kashmir. The April 2025 attack by Islamic terrorists on Indian civilians in Pahalgam, Kashmir, brought India and Pakistan to the brink of war with heavy shelling and artillery fire across the Line of Control, until a ceasefire was finally reached.

The Taliban takeover in Afghanistan and its consequent international isolation have resulted in the rapid contraction of its economy, a rise in poverty, and the deterioration of human rights, especially for women and girls. The closure of the Afghan Embassy in New Delhi and Afghanistan's souring relationship with Pakistan point to a regionally isolated Afghanistan. In the last decade, Bangladesh's economy has emerged as one of the most robust in the region, but longer-term progress now depends on how it manages its democracy. In June 2024, mass student protests in Bangladesh escalated into an uprising against the government of Prime Minister Sheikh Hasina, and flee the country, sparking a constitutional crisis. The interim government under Nobel Laureate Muhammad Yunus is working toward elections in 2025 even as it grapples with the political and economic fallout of the crisis.

The recent election of a pro-China presidential candidate, Mohamed Muizzu, in the Maldives has significant implications for India and China. President Muizzu's campaign agenda focused on an "India Out" policy, which is in marked contrast with his predecessor, Ibrahim Solih, who was largely believed to be pro-India. How this change in government will play out for India's or China's strategic interests in the Indian Ocean region remains to be seen. Following the political and economic crisis in Sri Lanka in 2022, the economy has been on a slow path to recovery. India and China have extended their support to Sri Lanka over the last year and continue to vie for influence. Nepal's current ruling coalition appears relatively stable, but Nepal hasn't had a government that has survived a full five-year term in more than two decades. Its low-growth economy shows no sign of immediate recovery. Nepal needs new avenues of investment and growth to stem economic stagnation. However, despite recent bilateral visits with India and China, there have been no significant breakthroughs on key issues such as energy trade, connectivity, or investment.

Gaps in Prevalent International Relations Theories on Small States

Since the end of World War II and subsequent decolonization, small states have grown in number. Today, small states play an increasingly significant role in global governance through multilateral institutions and forums where one-country-one-vote rules apply. However, there is remarkably little agreement on what constitutes a small state.[8] More than a quarter of UN member countries are countries with a population of 1.5 million or fewer. Yet some appear in the top 20 countries when ranked based on GDP per capita. Often, the value of their natural resources and/or the extent of their economic and trade ties place small states in a geopolitical position of influence that far outweighs their size.

Similarly, taking geographic size into consideration, the United Kingdom is ranked 80th among countries, but is the sixth largest economy and a permanent member of the UN Security Council. Going by the size of the economy, comparably sized economies such as Israel and Singapore are quite asymmetric in terms of their military power and regional influence. Additionally, whether a country is in active internal or transboundary conflict also seems to matter, as countries in conflict tend to have a more complicated involvement of global and regional powers than those that are relatively stable.

Given these definitional incongruities, this paper takes the approach of putting countries in South Asia that are "situationally similar"—or, as Thorhallsson and Wivel have called it, "within specific spatio-temporal context"—when it comes to managing relationships with their disproportionately powerful neighbors that are competing for influence in the region.[9] The five countries that this paper has chosen to include in this comparative analysis also have a few key features in common:

- All five countries are located close to India, where China has historically had limited influence.
- None of the five countries has fought with India or China in recent history, nor do they have military strategies directed against either nation (unlike Pakistan).
- No significant internal or transboundary armed conflicts are occurring in any of the five countries (unlike Afghanistan).
- All five countries have rapidly growing trade and economic relationships with China, which has raised concerns in India, as the latter has traditionally viewed South Asia as its primary sphere of influence.

Definitional complications aside, some of the widely used theories in international relations literature do not adequately explain how small states respond to big power competition and geopolitical rivalries. The theoretical expectation from existing literature is that small states may employ a combination of the following strategies:

- **Neutrality or non-alignment:** Neutrality enables small states to avoid becoming embroiled in the geopolitical contests between more powerful states. For some small states, such as Switzerland, adopting a permanent state of neutrality has ensured a level of international security and stability. Other examples of de facto neutral states include Ireland and Austria. Non-alignment is a variant of neutrality, which gained prominence during the Cold War, when many newly independent states in Asia and Africa refused to align themselves with the U.S or the Soviet Union.[10]
- **Alliance formation:** Membership in international blocs and alliances can provide small states with a tool to secure their own national security and economic interests and provide them with leverage and lobbying power to mitigate against the unilateral actions of larger and stronger states. In Europe, EU and NATO membership have, for example, provided small states with the ability to play a more strategic and influential role in the region.[11]
- **Balancing, bandwagoning, and hedging:** Small states often adopt a mix of alliance strategies—balancing, bandwagoning, and hedging—to protect their security, economic, and strategic interests amid shifts in the global order.[12]

- Balancing refers to small states aligning with others—often fellow weaker states—to counter a stronger power collectively. NATO is a classic example: a defensive alliance of 32 member states, one-third of which are small states.
- **Bandwagoning** is when a small state aligns with a stronger power to benefit from its protection or influence, rather than oppose it.
- **Hedging** involves avoiding firm alignment with any one power, allowing small states to reduce security risks while preserving strategic flexibility. A key example is ASEAN states' strategy of navigating between the United States and China, the two major powers competing for influence in the Asia-Pacific.

- **Championing multilateralism and adherence to a rules-based order:** This enables small states to address power asymmetries between states, reduces the costs of diplomacy, and provides some buffer against the unilateral actions of larger, more powerful states.[13]
- **Economic diplomacy:** Small states employ various economic diplomacy tools—such as trade promotion, foreign direct investment, export of goods and services, e-commerce, preferential trade agreements, and tax incentives—to capitalize on their comparative advantages (e.g., natural resources, geographic location). These strategies help advance their economic, foreign policy, and security interests. Many also leverage economic interdependencies, particularly in commodities, critical minerals, and energy trade, as seen in oil-rich Gulf states or mineral-rich African countries.[14]

In this paper, we demonstrate that small states, including those in South Asia, rarely stick to a single strategy or a specific combination of strategies in a consistent manner. There are two main reasons for this. First, there are inherent risks and drawbacks to consistently following the same strategy. For example, constantly maintaining a stance of neutrality or non-alignment might lead to isolation, especially when faced with an existential threat. Likewise, strategies like hedging or balancing may fail in certain situations, particularly when competing powers converge on the same issue, resulting in "with us or against us" scenarios.

Second, these theories assume that small states can make rational decisions that best serve their national interests in most situations. However, in practice, domestic political economy factors influence many foreign policy decisions. These decisions may be driven by the narrow political or financial interests of ruling elites and influential interest groups within the country, or they may be shaped by the political expediencies of the ruling parties, rather than by a genuine pursuit of the country's broader national interests. This general lack of predictability is where attempts at "gaming" the behavior of small states also begin to pay fewer dividends.[15]

Given that small state behavior is generally not consistent across cases and that in many instances policy positions could be undergirded by narrow political economy interests rather than established, broad-based national interests, this paper attempts to build a conceptual framework of small state behavior from the ground up based on the case studies conducted in five South Asian countries.

Analytical Framework

As the 15 cases analyzed for this research do not readily yield an elegant set of explanations for small states' behavior in the face of intensifying regional power rivalry, rather than positing an all-encompassing theory of small states behavior, we have instead outlined an analytical framework that attempts to categorize the responses along a two-by-two matrix. The rationale for such an approach is as follows.

First, structural realists have long argued that domestic politics is incapable of changing international power relations, and states—small or otherwise—must make their strategic choices based on international and not domestic politics.[16] In such moments, however, policymakers in small states must consider domestic political implications of their policy choices. This predicament, in turn, creates a situation where policy choices that generate short-term political gains become more attractive to ruling elites than policy choices that may be considered favorable to broader national interests in the longer term. This is why it is valuable to look beyond surface-level domestic politics and examine how ruling elites and their political economy interests shape foreign policy decisions. We approached this by applying a Political Economy Analysis lens to categorize and analyze the cases.

Political Economy Analysis (PEA) is a tool to map and analyze the processes through which powerful actors exert formal and informal influence on decision-making processes to pursue their political and economic interests. This tool is increasingly being used in the international development sector to understand why and how change and reform measures hit political resistance in governance institutions, although it can be helpful in other policy contexts as well.[17]

Domestic political elites and their political economy interests tend to have a deep bearing on small state behavior, particularly when institutions designed to protect and promote the rule of law are weak and characterized by public accountability deficits, lack of transparency, and prevalence of corruption. This becomes especially pronounced in relation to protecting the political survival of elites and securing proceeds of corruption in infrastructure contracts, defense procurements, preferential agreements, and other bilateral transactions. In most developing countries, including in South Asian small states, this factor is difficult to ignore, and in some instances, this is the key factor that drives foreign policy decisions.

Second, in international relations literature, the strategic choices that small states have in dealing with big powers are often characterized as dilemmas.[18] This is mainly because small states are usually not positioned to shape the choices or control the outcomes independently. They usually must "respond" to choices framed by big powers and work with big powers to shape the outcome of their choices. Given the asymmetry in capabilities and potential risk associated with this kind of proposition, foreign policy decisions in small states are often internally and externally contested.

On the other hand, what small states routinely confront as "choices" essentially boils down to whether to lean in one direction or seek to balance relations. Small states can maintain neutrality or remain unaligned only as long as they are perceived as geopolitically insignificant. The moment their strategic value increases—like Cambodia and Laos during the Vietnam War—the option to remain neutral or unaligned rapidly diminishes. Even during peacetime, being in the wrong geostrategic location makes things tricky.

All South Asian small states share this predicament. Sri Lanka and the Maldives are in the middle of a major sea route, and the value of their location in any full-blown regional war in the Indian Ocean will not escape any war strategist's mind. Nepal and Bhutan are landlocked buffer zone states between India and China. Bangladesh borders active conflict zones of Myanmar on one side and India's "narrow corridor" on top.[19]

Given this geographic location, it is difficult for South Asian small states to stay neutral or unaligned in the current geopolitical environment. They can indeed choose to leverage their bargaining positions by periodically shifting between balancing strategies and leaning strategies. Still, as mentioned above, these choices are difficult, fraught with the possibility of domestic polarization, and as observed in our case studies, characterized by inherently destabilizing effects.

Based on the above arguments, this paper uses a two-by-two matrix to categorize the cases from five South Asian countries (see below). The horizontal axis moves from policies driven by political economy interests of the ruling elites on one end to policies driven by broad-based national security interests on the other. In practice, policy positions may move on a spectrum rather than fit neatly in one box or the other. For analytical purposes, however, we can assign cases to one or the other box by looking at their dominant features.

	Driven by political economy interests of the elites	Driven by broad-based national security interests
Leaning/bandwagoning	Internally and externally challenged (Least stable condition)	Internally stable, externally challenged
Balancing/hedging	Internally challenged, externally stable	Internally and externally stable (Most stable condition)

The vertical axis runs from leaning and bandwagoning at the top to balancing and hedging at the bottom. This excludes policy positions that are truly neutral, which are practically unattainable and, therefore, can be considered analytically irrelevant. Here, too, policy positions taken by small states are expected to land on a spectrum somewhere along the vertical axis but can be located in one or the other box as a categorization exercise.

This analytical framework has allowed us to interpret the case studies (see the section below) along two postulates. First, if a small state chooses to lean heavily or bandwagon with one of the rival powers and if the decision is largely driven by the political economy interests of the ruling elites, we are likely to see greater instability and flip-flopping in the policy positions. Such a policy position is always exposed to the risk of domestic political challenge as well as efforts by the other power to upend it. Second, if a small state chooses to seek a balance or hedge risks between the rival powers, and if the decision is based on a broad-based national security interest, we will likely see greater stability in policy positions. Such a policy position, however, is exposed to the risk of both rival powers wanting to upend it to their own advantage.

Analyzing Case Studies

In this section, we start with a brief description of the geopolitical context in which the responses and strategies employed by the five countries we studied can be located. We then place the 15 cases in the two-by-two matrix discussed above. Finally, we discuss the patterns we have observed and the inferences we have been able to draw from this exercise.

Key Features of the Geopolitics Context

Bangladesh

The intensifying Indo-Chinese rivalry in South Asia has allowed Bangladesh to maximize economic and strategic benefits from both regional powers. In specific instances, such as the Rohingya crisis and the decades-long Teesta water-sharing dispute, Bangladesh has tried to leverage its relationships with India and China to extract concessions or favorable political outcomes while remaining officially neutral. However, a selective reliance on external powers like China for mediation has not yielded tangible results, as seen in the failed Rohingya repatriation efforts. Similarly, India's reluctance to resolve the Teesta water-sharing issue—due to its subnational political constraints—reflects the limitations of Dhaka's leverage over New Delhi.

Bangladesh's foreign policy positions toward India and China have been strongly aligned with domestic political considerations. For decades, the ruling party under former Prime Minister Sheikh Hasina pursued a foreign policy based on prioritizing alignment with India, China, and Russia, which were seen as less critical of democratic backsliding in Bangladesh than the United States and other Western powers. Public opinion on Bangladesh's foreign policy has been critical, particularly regarding its perceived submissiveness to India and inability to secure concessions from China or solve critical issues like the Rohingya crisis and the Teesta River dispute.

Bhutan

As a buffer state between China and India, Bhutan's sovereignty and territorial integrity is an existential and pressing concern for the mountain kingdom. Consequently, Bhutan has worked to carefully maintain its sovereignty by capitalizing on its relationship with India while cautiously expanding informal relations with China. It remains the only South Asian country without formal diplomatic relations with China, yet it strategically manages potential tensions. Bhutan has skillfully managed sensitive border issues, such as the Doklam tri-junction with China and India, demonstrating diplomatic acumen in preventing escalation and protecting its territorial interests without compromising its sovereignty. Bhutan relies heavily on Indian financial support but has actively sought to diversify its development financing by engaging with multiple international partners like the European Union, Japan, UN agencies, the Asian Development Bank, and the World Bank to reduce single-country dependency and maintain economic independence.

Nepal

Nepal's geostrategic location between India and China has meant greater interdependence on the two Asian powers for trade and transit but equally opportunities for Nepal to capitalize on the intensifying rivalry to extract economic benefits and investment. Foreign policy is increasingly a matter of public discourse and debate in Nepal and is highly politicized. Public perceptions of Indian high-handedness in cases such as the Madhesi blockade in 2015 and other cross-border matters have led Nepal to pursue a more pro-China stance in certain spheres, such as transit, infrastructure, and hydropower. Notably, in 2016, Nepal signed a Transit Agreement with China, which is seen as balancing India's influence and providing Nepal with more strategic and economic autonomy.

Occasionally, Nepal has been able to engage in "bluff diplomacy," playing on India's concerns regarding Chinese influence in Nepal, to accelerate India's commitments on trade, infrastructure, and other investments. However, in other instances, Nepal has struggled to balance relations with India and China, such as India's refusal to purchase power from Chinese-funded hydro-power projects or to allow access to airspace over India for flights to Pokhara airport. Nepal's ability to use its position with respect to India and China is constrained by its political context—marked by a long history of political instability, poor governance, and slow economic growth. Many of its foreign policy responses appear as ad hoc, tactical responses rather than the result of a carefully calibrated foreign policy.

The Maldives

Like Sri Lanka, the Maldives is strategically located in the Indian Ocean. The atoll island country has welcomed infrastructure investments from both China—the Sinamalé Bridge under BRI—and India—the Greater Male' Connectivity Project—leveraging the competition to fulfill domestic developmental goals while avoiding complete alignment with either power. Free trade agreements with China and discussions of a trade agreement with India reflect the Maldives' effort to maintain economic ties with both nations, balancing opportunities for growth with sensitivity to Indian security concerns. Historically, defense cooperation has been stronger with India due to proximity, shared regional security concerns, and India's swift responses to crises, such as the 1988 coup attempt.

However, there are deep national sensitivities associated with any foreign presence on Maldivian soil, as evidenced by the recent protests against the stationing of Indian troops in the Maldives. Defense ties with China remain minimal and focused primarily on economic collaboration. Maldivian politicians often use relations with India and China for political leverage, employing narratives about sovereignty and foreign influence to sway public opinion and fulfill campaign promises. The Maldives benefits from the rivalry by securing investments and aid but lacks a long-term strategy, relying instead on reactive decisions.

Sri Lanka

Sri Lanka's geostrategic location on key trade and transit routes in the Indian Ocean has enabled it to attract investments from both India and China—such as China's BRI projects like the Hambantota Port and India's investment in energy infrastructure and railways. The island nation has frequently adopted a hedging strategy, engaging both India and China to maximize economic and strategic benefits while attempting to avoid complete alignment with either power. Examples include the Colombo Port Expansion Project, where Sri Lanka allowed China to develop the Colombo International Container Terminals and later involved India and Japan in the Eastern Container Terminal to maintain balance.

There have been growing domestic concerns around an overreliance on China and Chinese-funded projects, such as the Hambantota Port and Mattala Airport, which have led to significant debt burdens. These concerns were exacerbated by the 2022 economic and political crisis that resulted in a change in government. Sri Lanka's internal governance issues, political instability, and lack of comprehensive feasibility studies have undermined project outcomes, such as the underutilization of the Mattala Airport and the Colombo Lotus Tower. Political factions often align with different external powers based on expediency, creating inconsistent foreign policy and complicating long-term strategic planning.

Locating the Cases in the Analytical Framework

In each of the five countries studied for this paper, researchers selected three cases that illustrate how the states approach and manage large power rivalry in the region (See Annex 1: List of Cases Studied). The cases cover a range of areas and sectors within bilateral relations, including trade, transit and connectivity, development assistance and investment, special economic zones, regional migration and refugees, and development of strategic infrastructure such as ports, bridges, energy plants, and transmission lines. As none of the five countries studied were experiencing an existential external or internal threat from armed conflict at the time of analysis, the cases can be said to exemplify small state behavior under normal conditions.

In the interest of brevity, the full case studies are not included in this paper. The case studies and analyses for Bangladesh, Nepal, and Sri Lanka are available as standalone papers. Due to current political sensitivities, the Bhutan and Maldives papers are not being released at this time.

We describe cases briefly in Annex 1, and where relevant, particularly when we begin to draw inferences from our analysis. Here, we are interested in the patterns we can observe while locating the cases in the matrix.

	Driven by political economy interests of the elites	**Driven by broad-based national security interests**
Leaning/bandwagoning	Mattala Rajapaksa Airport and Columbus Lotus Tower (SL1) Trincomalee Oil Farm Lease (SL3) Small Development Projects (BH3)	India-Bhutan Trade & Transit (BH1) Financing Five-Year Plans (BH2) Sinamale China-Maldives Friendship Bridge (ML1) MCC Compact (NP3)
Balancing/hedging	Rohingya Refugees (BG1) Greater Male Connectivity Project (ML2) China-Nepal Transit Agreement (NP1)	Downstream Teesta Barrage (BG2) Diversifying Trade Relations (BG3) Free Trade Agreement with China (ML3) Diversifying Hydropower Markets (NP2) East Container Terminal (SL2)

We see some readily observable patterns in the table above. First, none of the small states we studied appears to have a consistent strategy across all three cases. Further, there is no country with all three cases in one quadrant. Even in the case of Bhutan, which does not want to appear overtly to be deviating from its India-leaning stance, we see attempts to resist or reshape international cooperation propositions based on the political economy interests of the ruling elites. Second, balancing and hedging appear to be the preferred choice of strategy for all small states, but importantly, not in all instances. Third, the oscillations between balancing and leaning strategies tend to have an iterative pattern. It is almost as if going in one direction creates the argument for going in the other direction iteratively.

Going beyond the graphical patterns and analyzing the qualitative elements of the 15 cases, we can make four assertions on small state behavior in the context of a spiraling geopolitical rivalry in South Asia:

First, small states in South Asia are rarely able to maintain internally and externally stable strategies toward regional power rivals.

Small states in South Asia have been heavily India-leaning until three decades ago because of long-standing geographic, colonial, sociocultural, and economic ties with India. However, since the 1990s, as China began to make inroads into the region, some of India's influence has eroded. Despite China's substantive efforts in the last decade, the region's historical context gives India a disproportionate advantage. However, when we look at the core foreign policy doctrines of the South Asia small states, except in the case of Bhutan, all four countries—Bangladesh, Sri Lanka, Nepal, and Maldives—officially aspire for an equidistant, non-aligned, and neutrality-seeking relation with the two regional powers. The aspirations for managing and attaining an "equidistant" relationship with regional powers often collide with the economic and geographic compulsions to stay India-leaning, resulting in instability in countries' foreign policy positions.

For example, the Maldives is a country heavily courted by both India and China due to its strategic location in the Indian Ocean Region on key maritime economic and strategic routes. Here, we see the most interesting seesaw between the foreign policy positions of successive governments. The Maldives has a long-standing defense cooperation arrangement with India, under which the country has received military hardware, including radars, patrol vessels, rescue aircraft, and helicopters. In addition, the two countries routinely conduct joint naval exercises.

Despite strong historical ties and a long history of cooperation, a small contingent of Indian officers stationed in the Maldives is periodically asked to leave or remain on Maldivian soil, depending on the political party in power. Notably, President Mohamed Muizzu's 2023 election campaign focused heavily on an "India Out" policy—seeking the removal of Indian boots from the Maldives. Seen as pro-China, Muizzu's policy position toward India was in marked contrast to that of his predecessor, Ibrahim Solih, who was seen as pro-India. Following his election in 2023, one of President Muizzu's first acts in office was to ask India to withdraw all Indian military personnel stationed in the country. Similarly, regarding infrastructure and investment, the Maldives has frequently wavered between India and China. For instance, in 2015, former President Yameen (2013-18) signed an agreement to build the USD 202 million Sinamalé Bridge with China and followed this by signing a free trade agreement in 2018. His successor, President Solih, then turned to India and signed a deal to build the USD 500 million Thilafushi-Male Bridge. In recent months, current President Muizzu has dialed back on his "India Out" campaign, making a state visit to India in October 2024 focused on enhancing bilateral trade and investment ties with India and courting New Delhi, seeking to strengthen bilateral trade and investment ties with India. This suggests that political expediency and domestic concerns are often far more critical factors in determining small state responses to big power rivalries than they are conventionally given credit for.

Second, leaning or band-wagoning strategies are fundamentally risky when driven by political economy interests of the ruling elites.

When a government's domestic legitimacy is weak, and it attempts to legitimize its rule on the back of a regional power, as has been seen in the case of Bangladesh or the military junta in Myanmar, the small state in question as well as the regional power's long-term strategic interests come under significant risk. Bangladesh illustrates this.

The now-deposed Prime Minister Sheikh Hasina came to power in Bangladesh in 2009 in a legitimately contested election. The successive elections in 2014, 2018, and 2024 were widely regarded as "fixed" by the opposition parties who accuses of being methodically sidelined through oppressive measures. Prime Minister Hasina reliance on India, in turn, brought support for her government based on its strategic calculations. To expand her political base and cut into the BNP's constituency, her foreign policy repeatedly resorted to hedging and balancing strategies, but in each instance, she could not control the outcome in her favor.

The Teesta River case in Bangladesh exemplifies why such strategies do not work as intended. The Teesta River is a transboundary river flowing through India's strategically sensitive 22-kilometer corridor that connects mainland India with its northeastern states. Bangladesh has wanted a water-sharing treaty with India on the Teesta River for more than four decades but has been unable to achieve it mainly due to objections from the Indian state of West Bengal, through which the river flows. After years of trying, Prime Minister Sheikh Hasina wanted to demonstrate her "balanced" approach to regional relations by unilaterally building a flood control and irrigation system downstream of Teesta in Bangladeshi territory.

China saw an opportunity and offered Bangladesh a USD 1 billion loan for the project. Immediately after the 2024 elections, however, India upped the ante and offered a USD 1.1 billion loan. This made China rethink its offer, and in conjunction with Hasina's intentions to prop up the Rohingya Refugee issue, around which both Myanmar and China have always had a skeptical view of Bangladeshi intentions, China eventually withdrew the offer. A few months later, Prime Minister Hasina's government in Bangladesh fell in a popular uprising, forcing the country into a difficult and contentious transition and a faltering economy.

This case had its antecedents in Sri Lanka, where a similarly unpopular government drew in three BRI projects with poor feasibility—the Mattala Rajapaksa International Airport, the Colombo Lotus Tower, and the Hambantota Port—occasionally also courting India and eventually polarizing its own population to the effect of further eroding its legitimacy. As in Bangladesh, the ruling family—the Rajapaksas—fled the country, exposing it to a long-term political transition and an economic debacle from which Sri Lanka is still struggling to escape.

Third, a balancing and hedging strategy built around narrow political economy interests of the ruling elites is the most common approach employed by South Asian small states.

As the cases from the Maldives, Bangladesh, and Sri Lanka demonstrate, in the South Asian small states, balancing and hedging strategies are politically more popular among the populace than leaning or bandwagoning strategies. An overtly bandwagoning strategy driven by the ruling elite's narrow interests often backfires politically, sometimes resulting in mass uprisings. Given this predicament, the ruling elites in small states often guise their bandwagoning intentions with a peppering of balancing and hedging attempts, as in the case of Hasina's Bangladesh or Rajapaksa's Sri Lanka. In some ways, where India and China are concerned, this is to be understood as a rational political move, given India's preeminence in the South Asian economy, connectivity, and soft-power domains like tourism and cultural influence.

The case that fundamentally supports the above assertion, however, is that of Nepal, which has often described itself as a "yam between two boulders," indicating that any wrong move could lead it into an unfavorable position. At the same time, Nepal's foreign policy does not carry the legitimacy of a broad-based consensus on how to deal with its two giant neighbors, apart from an exalted ideal of being equidistant to both.

On the ground, however, the reality is different. Nepal has a 1,400-kilometer open border with India, more than 80 percent of its trade happens with India, its currency is pegged to India's currency, and India has a monopoly over its oil market. Even a few weeks of disruption in the supply chain or transit route have the potential to drive Nepal into a complete scarcity of essential goods, as happened in 2015 when India, citing its displeasure with some of the provisions in the new Nepali Constitution, brought Indo-Nepal trade down to a trickle. Despite this overwhelming dependency, Nepal, like other small states in South Asia, repeatedly flexes its muscles to demonstrate that it also has China as an option.

The political maneuvers behind this type of posturing may or may not hold real significance, but smaller states feel compelled to engage in such tactics. In the immediate aftermath of the 2015 de facto Indian blockade, Nepal signed an agreement with PetroChina to supply fuel and negotiated a bilateral trade and transit agreement with China. These two instruments formalized the "potential" to find an alternative fuel supply and other essentials for Nepal. Still, going into the agreement itself, both countries knew that this was not a viable alternative to the vast and much more efficient supply chain already in place with India. Given that road linkages between the two countries are not commercial-grade roads and the supply route is at least four times longer than that from India, the move was more political than practical. Ten years after the blockade, not a liter of fuel flows from China to Nepal, and the trade volume has not increased significantly from 2016 levels. However, moves of this nature are common in most small states in South Asia.

Fourth, small states that lean or bandwagon with a regional power to secure their national security interests still have to contend with popular discontent over sovereignty interests.

India and Bhutan have what may be called a "special relationship" compared to all other South Asian small states. The Indo-Bhutan Treaty of Friendship and Cooperation of 1949 was essentially a handover from the British Raj in India, where Bhutan was obligated to consult India on all matters related to external affairs. This was modified in 2007 to allow Bhutan to conduct its foreign policy as long as it does not harm India's security interests. This arrangement, and the fact that Bhutan does not have a bilateral relationship with China, puts Bhutan in a unique bracket.

While this arrangement ensures Bhutan's national security and territorial integrity, it also encroaches on its sovereignty when dealing with China. This issue occasionally arises because Bhutan and China have unresolved border disputes, and China has offered enticing land swaps that do not sit well with India's security interests in the Doklam area just above the Chicken's Neck. China's strategy of putting Bhutan in a typical small state dilemma may or may not work, but it is important to note that no stone remains unturned in this game.

Conclusion

Contrary to conventional views that small states are constrained by their size, population, and economic might, this paper and the companion analyses illustrates that small states

can draw on a range of diplomatic strategies and tools, across different domains—military, economic, cultural, environmental—to secure their national interests, gain benefits, and/or respond to changes in their external security environment. At the same time, small states must negotiate an increasingly unstable, conflict-ridden, and economically unstable geopolitical environment. In the face of this, small states need to be agile, flexible, and entrepreneurial in their strategies, approaches, and tools to secure their interests and respond to changes in their external environment.

The actions of small states are also equally a product of internal factors, such as the pulls and pressures exerted by domestic elites, voting constituencies, political leadership, the state of the economy, and systems of governance. Thus, any analysis of small state strategies and capabilities in contemporary geopolitics must look at both the internal and external drivers of small state behavior.

It is clear from these case studies that South Asia offers a rich and dynamic context for studying small state behavior. The region is currently experiencing far greater instability than it has in nearly two decades, marked by armed conflict between India and Pakistan, as well as political and economic instability in countries such as Afghanistan, Bangladesh, Pakistan, and Sri Lanka. As countries in the region grapple with domestic issues, geopolitical rivalries between larger powers impact regional stability, often exacerbating local tensions and conflicts. This is particularly concerning for landlocked countries like Nepal and Bhutan, which share borders with India and China, but it is equally a concern for maritime countries such as Sri Lanka and the Maldives, whose strategic location in the Indian Ocean renders them key actors in regional geopolitics.

Second, going beyond conventional international relations theories, this paper has advocated for employing a political economy analysis lens in analytical frameworks so that we stop seeing the state as a monolithic, rational actor and start seeing states as representing the flexible, often self-serving agency of ruling elites as well. This reflects the fact that foreign policy is increasingly domestic policy, as small states are under pressure from domestic constituencies to rapidly deliver on expectations for economic growth and development. There is, therefore, a strong domestic political incentive for small states to look for the best "deal" or investment propositions.

These case studies make it abundantly clear that small states do not live in or operate in a world of neat categories. Rather, depending on the situation, small states often move between strategies, adapting and responding to dynamic pressures. This is seen in cases where states must balance between competing powers—sometimes aligning with one, sometimes engaging both, or even hedging against potential risks. This adaptability and fluidity underscore the need to look beyond static categories and recognize the agility and ingenuity that small states demonstrate.

Finally, this analysis highlights that small states politically tend to gravitate toward stability, preferring balancing or hedging over leaning or bandwagoning toward one or the other power. However, their inability to control domestic and internal politics means these strategies do not play out as expected. Consequently, small states often switch between the two strategies in an extremely ad hoc and resolutely self-serving way.

Annex 1. List of Cases Studied

Country	Case No.	Title	Summary
Bangladesh (BG)	BG 1	Rohingya Refugees (BG1)	Since the onset of the 2017 Rohingya crisis, Bangladesh has hosted more than one million refugees fleeing genocide in Myanmar's Rakhine State. The prolonged presence of the refugees has imposed significant economic, social, and security burdens on the country. Despite initial international sympathy, aid has declined, law and order in refugee camps has worsened, and attempts at repatriation have repeatedly failed. Geopolitical factors—particularly the influence of China, India, and Russia—have prevented Bangladesh from mounting strong international pressure on Myanmar. Western support has been limited and complicated by tensions over governance and human rights issues in Bangladesh.
	BG 2	Downstream Teesta Barrage (BG2)	The Teesta River, a vital water source for northern Bangladesh, remains a point of long-standing contention with India. As a lower riparian state, Bangladesh has struggled with upstream diversions and the lack of a fair water-sharing agreement. Despite years of negotiations, opposition from the Indian state of West Bengal has repeatedly blocked progress. Frustrated by Indian inaction, Bangladesh explored a Chinese-funded river project, drawing sharp concern from India due to its proximity to the strategic Siliguri Corridor. Although Dhaka initially hedged between Chinese and Indian offers, it ultimately shifted toward India following political support from New Delhi.
	BG 3	Diversifying Trade Relations (BG3)	Bangladesh's foreign policy is increasingly shaped by its trade priorities. Its economic growth depends heavily on merchandise exports—particularly ready-made garments—to markets such as the United States, European Union, and the United Kingdom, while essential imports including raw materials and energy largely come from China and India. This dual dependency underpins Bangladesh's need to maintain balanced relations with both Western and Asian powers, avoiding alignment in major geopolitical rivalries to safeguard its economic interests.
Bhutan (BH)	BH 1	India-Bhutan Trade and Transit (BH1)	Despite graduating from the list of Least Developed Countries in December 2023, Bhutan's "landlocked" status between India and China presents significant challenges to its economic growth. This geographical reality hampers trade and commerce, resulting in high transportation costs, poor infrastructure and connectivity, and cumbersome transit regulations.
	BH 2	Financing Five-Year Plans (BH2)	Bhutan has historically maintained strong relations with its neighbor, India. The country's first five-year plan, initiated in 1961, was developed with India's assistance, and India has played a significant role in building capacity in Bhutan and supported the establishment of public sector institutions in Bhutan. While Bhutan has benefited financially and technically from India's bilateral support, it now faces a new generation of development challenges, including job creation and the need to diversify its economy. As a result, Bhutan is looking to expand its partnerships beyond India.
	BH 3	Small Development Projects (BH3)	India and Bhutan collaborate on small development projects (SDP) focusing on grassroots development in Bhutan's rural areas. Established during Bhutan's 10th plan, the SDP grants program supports community-driven initiatives in infrastructure, livelihood, environmental conservation, and capacity building. The SDPs aim to address infrastructure gaps and support national development goals, fostering goodwill between the two countries. However, challenges include local implementation capacity, project sustainability, and domestic concerns around perceived undue political influence from India.

Maldives (ML)	ML 1	Sinamale China-Maldives Friendship Bridge (ML1)	The Maldives traditionally maintained close economic and security ties with India. However, in recent years, particularly after moving from least developed country to middle-income status, the Maldives has sought to diversify its partnerships. Despite the geopolitical rivalry between India and China, successive governments in the Maldives have reached out to both Indian and Chinese investments for major projects. During President Yameen's administration for example, the Sinamalé China-Maldives Friendship Bridge project was funded by China, while his successor Ibrahim Mohamed Solih fostered closer ties with India, initiating the Greater Malé Connectivity Project, now under Indian funding. This complex relationship suggests that the Maldives navigates its funding sources without committing solely to one partner, while aiming to prioritize its national interests in the long term.
	ML 2	Greater Male Connectivity Project (ML2)	India is providing a USD 100 million grant and a USD 400 million line of credit for the Greater Malé connectivity project, which includes a 6.74 km bridge connecting Malé-Villingili-Gulhifalh and Thilafushi. The Thilamalé bridge is the Maldives' largest infrastructure project to date, aimed at enhancing trade and social connections. This initiative comes after the Chinese-funded Sinamalé Bridge from Yameen Abdul Gayoom's administration. Despite criticism of President Ibrahim Mohamed Solih's ties to India, this funding reflects a balance in relations with both India and China, which are competing for influence in the Indian Ocean Region. The nation's political parties seek to exploit this competition, with the Progressive Party of the Maldives associated with Chinese investments and the Maldivian Democratic Party seeking Indian support. Accusations of promoting "debt traps" and concerns over national sovereignty underscore the tension in these foreign affiliations.
	ML 3	Free Trade Agreement with China (ML3)	The Maldives has an established a trade relationship with China, becoming its third-largest import partner, with 15% of its imports coming from China as of July 2024. The Maldives signed its first free trade agreement with China on December 7, 2017, making it the second South Asian country to do so. This agreement aims to enhance economic cooperation under China's Belt and Road Initiative. While the agreement offers economic benefits, there are concerns about China's increasing strategic influence in South Asia. The Maldives is working to balance its relations with larger nations, particularly India, while also expanding its global economic partnerships. The idea that cooperating with one country requires distancing from another is being reconsidered as the Maldives navigates its trade relationships.
Nepal (NP)	NP 1	China-Nepal Transit Agreement (NP1)	The 2015 16 border blockade—imposed amid India's objections to Nepal's new constitution—exposed Kathmandu's near total dependence on India for its trade and transit needs. Shortages of fuel and essentials, coming on the heels of a devastating earthquake, created intense domestic backlash against New Delhi and propelled Prime Minister K.P. Oli to seek alternatives. In March 2016 Nepal signed a landmark Transit Agreement with China, secured a PetroChina fuel deal, and later joined the Belt and Road Initiative. These steps were framed as non alignment and diversification but, in practice, signaled Nepal's intent to hedge against Indian dominance by opening northern trade corridors and drawing Beijing into critical infrastructure projects.
	NP 2	Diversifying Hydropower Markets (NP2)	Since the early 1990s Nepal has pursued a "hydro export" model i.e. attract foreign capital to build large dams, sell surplus electricity to India, and bankroll development with the proceeds. Successive policies such as the Hydropower Development Policy 1992, Water Resources Act 1992 and Electricity Act 1992) welcomed private and foreign investors, but civil society pushback, a decade long conflict, and chronic political instability stalled momentum. The breakthrough came only after 2014, when Indian Prime Minister Modi signed power trade and development agreements that opened India's grid to Nepali power and granted Indian firms prime sites. Yet the 2015 Indian blockade exposed Nepal's vulnerability and triggered Indian rules barring imports from plants with any Chinese links, effectively fencing Chinese capital out of Nepal's hydro sector. Kathmandu has since bandwagoned with India—awarding additional projects without bidding, accepting a 10 GW long term export deal, and using India's exchanges to sell wet season surplus—while Chinese backed schemes languish.
	NP 3	MCC Compact (NP3)	In 2017, Nepal signed a USD 500 million compact with the Millenium Challenge Corporation—augmented by a record USD 130 million Nepali contribution—to build high voltage transmission lines (including a cross border link to India) and fund nationwide road maintenance. Because the compact must be executed within five years and can override domestic laws that directly conflict with its terms, it required parliamentary ratification and a government legal opinion. When a U.S. official later linked MCC projects to Washington's Indo Pacific Strategy, critics portrayed the grant as a geostrategic tool to counter China, raising alarms about sovereignty, military basing, and legal supremacy. A blizzard of claims and counter claims stalled the deal, despite broad, cross party involvement in its design since 2012.

Sri Lanka (SL)	SL 1	Mattala Rajapaksa Airport and Columbus Lotus Tower	China's Belt and Road Initiative has positioned Sri Lanka as a strategic hub due to its location on critical Indian Ocean trade routes. Major BRI projects like the Mattala Rajapaksa International Airport and Colombo Lotus Tower exemplify both the promise and pitfalls of such investments, as they have brought economic opportunities but also stirred significant geopolitical tension. India, wary of China's growing influence so close to its borders, has viewed these projects with suspicion and responded with its own developmental and diplomatic efforts in Sri Lanka. Both China and India have used financial incentives, diplomacy, and strategic pressure to sway Sri Lankan decisions, with China providing loans tied to operational control, and India leveraging diplomatic channels and financial assistance to influence policy and limit Chinese involvement. In response, Sri Lanka has pursued a delicate balancing act, diversifying its partnerships to avoid overreliance on any single power and alternating its alignment based on shifting political contexts. By employing a hedging strategy, engaging both China and India, and emphasizing non-alignment and cultural diplomacy, Sri Lanka has attempted to maximize benefits while managing risks of debt dependency and loss of sovereignty.
	SL 2	East Container Terminal (SL2)	The East Container Terminal (ECT) of Sri Lanka's Colombo Port has become a focal point of strategic competition between China and India. The terminal, part of the Colombo Port Expansion Project, features significant modern infrastructure and capacity, attracting both powers due to its importance for trade and regional security. China has invested heavily in Sri Lankan infrastructure, using funding and technical expertise to gain influence, while India has sought to maintain its regional presence by providing development assistance and leveraging historical ties. Both countries have applied economic incentives and strategic pressure, with China's "debt diplomacy" raising concerns over Sri Lanka's sovereignty, and India emphasizing shared security and cultural links.
	SL 3	Trincomalee Oil Farm Lease (SL3)v	The Trincomalee Oil Tank Farm in Sri Lanka, originally built by the British and consisting of 99 largely intact tanks, has become a focal point in the strategic rivalry between India and China. India, through the Indian Oil Corporation and its subsidiary Lanka IOC, secured a 50-year lease on the site, forming a joint venture with Sri Lanka's Ceylon Petroleum Corporation, which holds a controlling 51 per cent stake. While this partnership grants India significant influence in Sri Lanka's energy sector, it also restricts Sri Lanka's ability to engage third parties or independently manage its energy assets, causing local resistance and public concern over national sovereignty.

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Small State Capabilities in Managing Regional Power Rivalries:

Case Study of Bangladesh

Parvez Karim Abbasi

This paper is part of a series of analyses of small-state strategies in navigating large-power competition. Experts were commissioned in Bangladesh, Bhutan, the Maldives, Nepal, and Sri Lanka to produce papers examining how those countries have managed relations between large powers such as China, India, and the United States, which are increasingly vying for political and economic influence across Asia.

The papers each examine three case studies that illuminate the strategies small states use to pursue their interests vis-à-vis large powers. In particular, the papers examine the domestic political considerations that shape the countries' actions, an underexplored dynamic in international relations research. A summary paper synthesizes the findings of the country papers and advances macro analysis and findings about the options and limitations for small states to maximize their positions relative to competing large powers.

Introduction

Bangladesh occupies an enviable geostrategic location of critical importance in Asia, as it sits between an increasingly prosperous yet politically volatile South Asia and economically dominant Southeast Asia. Meanwhile, the broader region feels the strains of the geopolitical and geoeconomic competition between the United States and China. Bangladesh, like other South Asian nations, has experienced the dominant influence of India owing to its landmass, population, economy, and military superiority.

The ongoing rivalry between India and Pakistan has been subsumed to a degree by rising tensions between India and China, which has made inroads in Pakistan, Sri Lanka, the Maldives, Nepal, Bangladesh, and Myanmar through China's Belt and Road Initiative, or BRI. China has made substantial investments and provided loans to develop physical infrastructure such as ports, bridges, power stations, and railways. In the past, smaller nations like Bangladesh had managed to play off the India-China rivalry to extract concessions. However, the return of great power competition between the United States and China has breathed new life into the South Asian geopolitical and economic dynamics. In certain instances, U.S. and Indian interests have converged, backed by economic and development assistance provided by the Japanese. Thus, there is a three-way power play between the United States, India, and China to exert tangible influence on how Bangladesh conducts its foreign policy.[1] China, the United States, and India are competing for hard power in Nepal and Bangladesh's political, economic, and security realms.[2]

Since its inception, Bangladesh's government has implemented a foreign policy based on the notion of "friendship to all, malice towards none"—which Sheikh Mujibur Rahman, the country's founding father, ingrained in the 1972 constitution.[3] However, that maxim was shaped by the intellectual legacy of the Non-Aligned Movement, which served as a useful policy during the Cold War. Traditionally, the relations between Bangladesh and India had been on a firmer footing when the Awami League government had been in power (1972-1975 and 1996-2001) and less so during the times of military dictatorships and the Bangladesh National Party (BNP) at the helm.[4]

Since 2009, the Bangladeshi government, under former Prime Minister Sheikh Hasina, has increasingly relied on Indian support. A significant degree of policy synchronization occurred between Dhaka and New Delhi.[5] The Bangladeshi government sought to create a certain degree of balance and autonomy from its dominant neighbor by joining China's BRI and courting significant Chinese investment. Notably, both the Indian and Chinese governments, along with new entrant Russia, showed considerable support for the Bangladeshi government after the controversial elections of 2014, 2018, and 2024.[6] In return, critical physical infrastructure investment projects in developing and acquiring ports, bridges, railway networks, electricity supply, and power plants were given to Indian, Chinese, and Russian state-owned and private companies. However, this has only spurred greater competition between India and China to extend or broaden their influence on Bangladesh's policy makers. Growing pressure from the West on human rights violations, electoral irregularities, and shrinking civic space has strained Bangladesh-U.S. ties. Bangladesh relies on the West as an export market, particularly for ready-made garments. The United States is Bangladesh's largest export market, the European Union is the largest bloc export destination, Japan is the largest development donor, and the United States is the largest cumulative investor. However, China and India are Bangladesh's largest import partners, and Chinese loans and investments have become more important.

This analysis uses Sheikh Hasina's 2009-2024 regime as a reference period. By examining three case studies, it provides a compelling example of how a small state attempts to conduct its foreign policy amidst geopolitical rivalry between its immediate neighbor, India, and near neighbor, China, and respond to increased U.S. pressure.

Methodology

The paper is based primarily on qualitative analysis with supporting quantitative data and figures. A review of existing literature, newspaper articles, and media reports was used when appropriate. In addition, this paper includes analysis from interviews conducted with two noted geopolitical experts and foreign policy analysts: Shafqat Munir, research fellow and head of Bangladesh Centre for Terrorism Research at the Bangladesh Institute of Peace and Security Studies, and Zillur Rahman, media personality, political analyst, and President at the Center for Governance Studies.

Case Study 1

Forcible Displacement of Myanmar Nationals

Bangladesh has been hard hit by the sudden influx of Rohingyas since the onset of the Myanmar government's 2017 campaign against the Muslim minority in Rakhine State.[7] Bangladesh currently hosts more than a million refugees and has been straining under the economic and financial costs amidst declining international funding. A marked decline in law and order and clashes with local communities have further complicated the situation for Bangladesh.[8]

However, due to the significant influence of China and India, and to an extent Russia,[9] Bangladesh has demurred from taking an active and aggressive role in pressuring Myanmar to take back its people. Owing to these pressures, Bangladesh has been unable or unwilling to proactively mobilize and engage Western capitals on the Rohingya issue. Bangladesh's Rohingya policy demonstrates the regional and international rivalries regarding the Rohingya crisis.

Domestic Considerations of the Bangladeshi Government

The Bangladeshi government under Sheikh Hasina sought to leverage the Rohingya crisis to bolster its public image abroad and to unite a fractious local populace at home behind a single cause. In the run-up to the 2018 election, the regime hoped its stance on the Rohingya crisis would help garner votes from the Muslim-majority electorate and also boost the premier's chances of being shortlisted for the Nobel Peace Prize.[10] The local print and electronic media became vociferous supporters of the Rohingya initiative of the Bangladeshi government and Islamic organizations, which gave their enthusiastic support. Local academics were enlisted to generate support on talk shows and in newspaper articles. There was an initial flurry of diplomatic activities, and Sheikh Hasina raised the Rohingya issue at the United Nations General Assembly in her speeches during 2017, 2018, 2019, and 2022.[11] She even issued a series of proposals for the UN compact, "Global Compact on Refugees: A Model for Greater Solidarity and Cooperation."[12] Widespread international condemnation of the crimes perpetrated by Myanmar's military—the Tatmadaw—and local militia forces translated into sanctions by Western countries, led by the United States, on key Burmese government officials and army personnel.

Meanwhile, multiple attempts to repatriate the Rohingyas have failed. Bangladesh and Myanmar signed the first repatriation deal in November 2017. They signed another agreement in January 2018 to complete the repatriation of all Rohingyas within two years. The failed attempts were followed by the military coup in Myanmar, which led to a complete collapse of meaningful communication between the two neighbouring countries.[13]

International Pressures

China

One of the key reasons why the Bangladeshi government failed to secure a decisive breakthrough on resolving the Rohingya crisis was the competing geopolitical pressures of major and regional powers. China, one of the closest supporters of the Awami League government, has significant geostrategic interests in Myanmar. Myanmar is the only immediate neighbour that provides China with convenient, direct access to the Indian Ocean, bypassing the contested South China Sea and congested Strait of Malacca, which the United States could potentially block in a conflict scenario. Such a connection is vital for exporting Chinese goods and importing fossil fuel from the Middle East and minerals from Africa. That is why China has built oil and gas pipelines from the shores of the Bay of Bengal to its southern province of Yunnan and plans to construct highways and a high-speed rail along the same route.

As part of the plan, Chinese state-owned entities are developing a USD 7.3 billion deepwater port at Kyaukphyu on the coast of Myanmar's Rakhine State and a USD 1.3 billion special economic zone, which includes an oil and gas terminal. Those projects are located at the lower end of the 1,700-kilometer China-Myanmar Economic Corridor connecting Kunming in China's Yunnan province to the Indian Ocean.[14] Chinese investment in Myanmar currently stands at 26 percent of total foreign direct investment, and bilateral trade is USD 2 billion.[15] China was understandably unwilling for Bangladesh to court Western—especially U.S.—support to threaten Myanmar's Junta's rule in the guise of helping the Rohingya population hosted in Bangladesh. Hence, China repeatedly encouraged the Bangladeshi government not to internationalize the issue and had even offered to mediate talks between Dhaka and Naypyidaw.[16] China, along with Russia, has vetoed UN Security Council resolutions aiming to hold Myanmar to account for its violent campaign against the Rohingyas.[17] However, these efforts have not translated into tangible gains in terms of Rohingya repatriation.

India

For decades, India has been a prominent economic investor and trading partner for Myanmar. As of 2022, India's development assistance to Myanmar, which includes infrastructure, amounted to more than USD 1.75 billion. This bilateral partnership includes highly publicized projects like the Kaladan Multimodal Transit Transport Project and the India-Myanmar-Thailand Trilateral Highway, which are crucial for India's Act East Policy. India has also helmed development projects like schools, roads, and housing along the India-Myanmar border and Rakhine State. Simultaneously, India is also one of the foremost buyers of Myanmar's vegetables, gems, and timber. In addition to 13 public sector undertakings, several private Indian companies like Century Ply, Tata Motors, and Essar Energy have a notable presence in Myanmar.[18] India also had close security and defense cooperation with the Tatmadaw for quite an extended period. Furthermore, India had been the most enthusiastic supporter of the Awami League regime of Sheikh

Hasina and had significant influence on Bangladesh's foreign and domestic policies. At the same time, India did not want to antagonize Myanmar and encouraged bilateral talks between Dhaka and Naypyidaw to resolve the crisis without relying on Western support.

Russia

Ties between Myanmar and Russia date to the Soviet era. However, in recent times, Myanmar has engaged Russia extensively to reduce its reliance on China. Russia provided Myanmar's military with USD 276 million worth of supplies between 2021 and 2022, compared to armaments valued at USD 156 million from China. A UN report states that Russian entities transferred USD 406 million in defense supplies to Myanmar during the same period, with China in second place at USD 267 million. Apart from Myanmar becoming a lucrative market for the Russian defense industry, Russia has also shown interest in oil and gas exploration and mining in Myanmar.[19] Russia also became a vocal supporter of the Hasina regime, especially after Bangladesh's contested elections in 2019 and 2024. Russian investment in Bangladesh's Rooppur Nuclear Power Plant gave Russia leverage over Dhaka. Russia was equally concerned about the threat of Western intervention in Myanmar and advocated a peaceful resolution of the Rohingya issue without Dhaka trying to internationalize it.

The United States and the West

The United States had multiple interests in Myanmar that would be served by the restoration of democracy (especially during the Biden era). First, the Biden administration had prioritized a values-based foreign policy, and Southeast Asia has witnessed a rise in authoritarianism over the past decade. Second, the military in Myanmar is the primary cause of its chronic instability, including its transnational crime epidemic. Third, the United States has an interest in a strong, central Association of Southeast Asian Nations (ASEAN) as an anchor in the Indo-Pacific. The Myanmar issue divides ASEAN politically, and a rehabilitated junta regime would likely act against U.S. interests within ASEAN. Fourth, Myanmar is of geostrategic importance to the Indo-Pacific, as it bridges South and Southeast Asia, and the military regime partners with revisionist actors, including China, Russia, Iran, and North Korea.[20] This militates against the United States' objective of denying China ingress into the Indo-Pacific.

U.S. legislators passed the U.S. Burma Act in December 2022, which included provisions to provide non-lethal assistance to Myanmar's ethnic armed organizations and the anti-junta People's Defense Forces.[21] Apart from imposing targeted sanctions on the military junta, it has worked closely with Canada, the United Kingdom, the European Union, and ASEAN to keep the military regime under pressure. As a part of its strategic objectives, the U.S. government wanted to engage the Hasina government more closely in implementing the Burma Act. However, continuous U.S. criticism of the absence of meaningful elections, violations of human rights, and intimidation of civil society and the media in Bangladesh caused a rift between Dhaka and Washington.

Criticisms of Bangladesh's Rohingya Policy

Experts interviewed about Bangladesh's Rohingya policy primarily characterized the policy as a failure. According to Mr. Shafqat Munir, the Rohingya policy of the Hasina regime was flawed from the outset. Rohingyas were taken in without any contingency planning. Opening the border for Rohingyas fleeing from Tatmadaw violence was initiated by Hasina, who thought that the move would garner positive attention from the international media and boost her image abroad. Her followers bestowed her with the title of "Mother of Humanity." The situation was exacerbated by a foreign secretary and a coterie of academics and intelligence agency operatives who did not provide a realistic assessment of the extent of challenges involved with Rohingya repatriation.[22]

Think tanks supporting government narratives started proliferating in Dhaka. Efforts to open a meaningful dialogue with Myanmar—then ruled by the National League for Democracy under Aung San Suu Kyi—were never pursued in earnest. After 2022, to appease China, Bangladesh undertook various attempts to carry out the involuntary repatriation of the Rohingyas. However, the efforts yielded little or no tangible results.

Zillur Rahman stated that the former prime minister was motivated more by the desire to be in the running for a Nobel Peace Prize when she decided to offer shelter to the Rohingya refugees. Neither she nor the Ministry of Foreign Affairs was able to gauge the degree of support China, India, or, for that matter, Japan would directly or indirectly extend to Myanmar. Excessive dependence on China prevented the Bangladeshi government from internationalizing the issue. Despite initial Western support, Bangladesh was not able to capitalize on it. This was due to the ongoing tensions between Bangladesh and the United States regarding U.S. concerns surrounding the state of democracy, human rights, and the rule of law under Sheikh Hasina. The foreign policy of Bangladesh was conducted at the direction of the former premier, without substantive input from Foreign Ministry or intelligence officials. India was driving Dhaka's foreign policy, and China was being courted for investment in infrastructural projects. NGOs were actively courted for funding as well. Competent academics, specialists, and private think tanks were rarely used.[23]

Dhaka's Policy Options and Eventual Policy Stance

The Awami League regime wanted to make the Rohingya issue the centrepiece of its foreign policy outreach. It aimed to raise its soft power while carefully deflecting and diverting international criticism of the shrinking of democratic and civic space at home. However, Bangladesh had to navigate conflicting objectives of two blocs—the Western bloc led by the United States, the United Kingdom, Canada, Australia, and the European Union, and the non-Western bloc led by China, India, and Russia. The Western bloc wanted Dhaka to internationalize the Rohingya issue and involve Western countries in putting pressure on the military regime in Myanmar. This policy required more aggressive posturing from Dhaka. India, China, and Russia, each with varied geostrategic interests in Myanmar, wanted Dhaka to opt for bilateral negotiations with Myanmar and were wary of greater Western involvement. There was a fear in New Delhi, Beijing, and Moscow that the United States would use the Rohingya issue as a pretext to gain a bridgehead in Bangladesh, which would provide it with greater strategic flexibility in terms of implementing its Indo-Pacific objectives.

At first, Dhaka attempted to balance between the conflicting objectives of the rival blocs. It tried to internationalize the Rohingya issue and welcomed Western media and NGOs to Bangladesh to provide wider coverage of the plight of the Rohingyas in the country. It also sought to secure the cooperation of China, Russia, and India in putting pressure on Myanmar to repatriate the Rohingyas. However, Russia and China's repeated vetoes of UN Security Council resolutions and India's neutrality/ambiguity made the task even more difficult. The military coup by the Tatmadaw in 2021 and the continued support of China, India, and Russia exacerbated difficulties.[24] The ineffectiveness of Western sanctions to dislodge the military regime and the decline in foreign funding for the Rohingyas in Bangladesh made the Bangladeshi government sour on the Western approach. Furthermore, with the United States' growing criticism of the lack of free and fair elections in Bangladesh, ties between Bangladesh and the United States and other Western nations grew increasingly strained. Conversely, Russia, China, and India lent unconditional support to Bangladesh and criticized perceived Western meddling in internal affairs and the sovereignty of Bangladesh.

Bangladesh unequivocally swung to the non-Western bloc and relied on mediation from China, with tacit support from Russia, to engage the Tatmadaw in repatriation talks. India chose to be neutral, mindful of not aggravating the junta and thus imperiling its connectivity project in northeast India. It opted for bandwagoning, following the lead of China to secure concessions and a change in the mindset of the generals in Myanmar. This further strained relations with the West. However, the onset of the COVID-19 pandemic and full-blown civil war led by the National Unity Government and ethnic armed organizations in Myanmar stalled the Chinese initiative.

Outcome and Implications

Bangladesh's foreign policy approach failed to resolve the Rohingya crisis in the country. Initial enthusiasm for the Rohingyas among the local populace gave way to fatigue and increased concern about the threat posed by deterioration in law and order, smuggling of narcotics, and increased violence in the refugee camps.[25] The prospects of repatriation dimmed, and the altered ground reality has led to less than favorable coverage and assessment of the government's Rohingya policy by the media and analysts.

Analysts and the public have questioned Bangladesh's ability to conduct an independent foreign policy regarding Myanmar.[26] Further, elites and the public have criticized the role of China, India, and Russia and cited the premier's hubris and desire to remain in power as a cause of foreign policy failure in this case.

Dhaka's stance under the Hasina regime compared unfavorably with Bangladesh's response to Myanmar's previous attempts to forcibly push in Rohingyas across the border. In May 1978, following the launching of Operation Nagamin (Dragon King)—a national effort to register citizens and screen out foreigners before a national census—around 200,000 Rohingyas had taken shelter in Bangladesh. Almost immediately upon the refugees' arrival, the Bangladeshi government engaged its Burmese counterpart in a discussion on their repatriation. Bangladeshi authorities complained of the economic and social burden of the presence of the Rohingya and insisted that there would be no local integration. The United Nations also urged the Burmese leadership to allow the Rohingyas' repatriation. UN officials hinted that a flow of aid, which the Ne Win government in Burma was pursuing through a more open foreign policy, would be more readily accessible should the ruling Burmese Socialist Programme Party agree to the returns. The Burmese government relented, and the Rohingya began to return home.[27]

Case Study 2

The Teesta River

Bangladesh's geography downstream from India and reliance on water from its neighbor have long been a source of tension. In 1977, Bangladesh filed a protest at the United Nations over the Farakka Barrage on the Ganges River. Teesta River water sharing has also been a source of dispute for decades, with Bangladesh claiming India has not adhered to sharing agreements.[28] The proposed interlinking project by the Indian government has also raised alarms in Bangladesh, as the countries share 54 common rivers.

China's offer to build a multipurpose dam in Teesta, close to the strategic Siliguri Corridor of Northeast India, rattled policymakers in New Delhi.[29] This is especially so considering the recent border clashes in Doklam, the renewal of tensions in Arunachal Pradesh, and rising unrest in states such as Manipur. India proposed a counteroffer, which was sparse on details, angered most Bangladeshis, and alienated China.[30] The Teesta episode provides a commentary on the Sino-Indian rivalry and power projection in Bangladesh.

Dhaka's Policy Options and Eventual Policy Stance

The Teesta River, a tributary of the Brahmaputra, is among the 54 transboundary rivers between India and Bangladesh. It flows southward from Sikkim and northern Bengal before entering Bangladesh. As the country's fourth largest river and the primary water source for its northern regions, it's crucial for irrigation, supporting millions of citizens and accounting for 14 percent of crop production. Upstream dam construction in the north-eastern Indian states has significantly restricted water flow and adversely affected Bangladesh.[31] During dry seasons, Bangladesh receives only a fraction of the 1,200-1,500 cubic feet per second of water it needs and much less compared to the perceived ideal 5,000 cusecs, with levels dropping even below 200-300 cusecs at times.[32] Matters have been made worse by the West Bengal Chief Minister Mamata Banerjee's persistent refusal to agree to a water sharing agreement between New Delhi and Dhaka, citing the adverse impact on agrarian communities in West Bengal. Banerjee torpedoed the water sharing agreement that was being finalized between the Singh government in India and Bangladesh in 2011. Her stance has not changed under successive governments of Narendra Modi.[33]

Faced with increasing disillusionment from India, Hasina turned to China to implement a USD 1 billion Teesta water project. Bangladesh sought USD 725 million from China for the project to ensure better water preservation on the Teesta River. China completed a survey, and Bangladesh began working with the Chinese. Still, construction stopped in 2022 after India raised security concerns about China's presence less than 100 kilometers from its borders and so close to the Siliguri Corridor.[34] After the 2024 elections, China requested that Bangladesh revise its loan application and submit a new implementation plan if the government still deemed the project essential, which Bangladesh agreed in principle.

However, the situation changed dramatically with Hasina's June 2024 visit to India, where she agreed to proceed with the Indian offer to finance the Teesta project, estimated to cost more than USD 1.1 billion. However, the Indian proposal was less concrete and emphasized conducting joint surveys to assess the water requirements of both countries. India was seen to have played a pivotal role in preventing excessive pressure from the United States on Bangladesh regarding holding free and fair elections in January 2024. Indian help was seen as crucial in securing Hasina a fourth term.

In the Teesta River case, Bangladesh practiced hedging between contrasting Chinese and Indian objectives. Hedging in this case refers to Bangladesh's balancing act between India and China, especially in an uncertain environment where the outcome of a conflict of competition is not clearly visible. By sending positive signals to both sides instead of aligning with one, hedging actors like Bangladesh want to avoid dependence on a single actor and maximize their political and economic profits. However, as the Hasina government felt beholden to India's intervention with the United States to secure a fourth term, it swung to India's position. Thus, the Bangladeshi policy on the Teesta River shifted from hedging to bandwagoning.

Outcome and Implications

Unfortunately, the shift in stance by the Hasina government on the Teesta River and openly aligning with India at the risk of alienating China was widely criticized at home by experts, academics, and the public.[35] There was a feeling that the Bangladeshi government, led by Hasina, had abandoned national interests at the expense of narrow political and personal ones. The Bangladeshi decision to grant a transport corridor to India to access its northeastern states was seen as an abandonment of a significant bargaining chip without extracting tangible results on Teesta water sharing.

The gloomy opinion was further solidified following Hasina's four-day visit to Beijing in July 2024. Instead of securing China's expected USD 5 billion assistance package to shore up depleted foreign exchange reserves and stabilize the economy, she was only offered USD 137 million.[36] China's ire at Bangladesh's overt alignment with India's interests was widely discussed in the local print and electronic media, and opposition parties, academics, and retired military personnel were openly critical of Bangladesh's foreign policy choice. Excessive reliance on India and alienation of China contributed to a decline in the already low public acceptance of the Hasina regime. Public sentiment was that over-reliance on India prevented the Teesta River issue from being solved in Bangladesh's favor.

Case Study 3

Trade Dynamics

The sustained economic growth of Bangladesh and its gradual integration into a globalized economy have influenced its foreign policy. The country aims to increase merchandise exports and ensure an uninterrupted supply of raw materials, intermediate commodities, and electricity via reliable import channels. The export and import dependence on various countries, such as the United States, the United Kingdom, the European Union, China, and India, means that Bangladesh's foreign policy is also dominated by its trading concerns and priorities. To a certain extent, Bangladesh behaves as a trading state because trade plays a key role in its economy.[37]

Richard Rosecrance (1986) elaborated on the concept of the trading state, which revolves around the emphasis placed by the state on economic factors while formulating and implementing foreign policy. According to his analysis, states are interdependent because of globalization, and a "trading state" prefers "soft power" instead of "hard power." These states choose cooperation and try to increase their role in global economic markets and gain economic development instead of occupying other states' areas.[38]

Regarding Bangladesh's exports, the top five leading destinations from 2015 to 2019 were the United States, Germany, the United Kingdom, France, and Spain. The U.S. remains the largest single-nation market, amounting to more than USD 6.8 billion in 2019. The RMG sector comprises nearly 84 percent of Bangladesh's annual exports, highlighting the extreme dependence on a single category of exports. Europe (62 percent of export value) and the United States (18 percent of export value) remain the RMG industry's leading customer markets, although dependency on the United States has decreased recently.[39]

China and India have been the leading import partners of Bangladesh for more than a decade and will continue to be dominant in the foreseeable future. Chinese imports to Bangladesh totaled USD 17.3 billion in 2019; India's imports amounted to more than USD 8.2 billion. Geographic proximity, which results in lower transportation costs, the availability of natural resources and intermediate goods, the relative affordability of manufactured fast-moving consumer goods, and a long history of political and commercial engagement all contribute to China and India's dominant position in the Bangladeshi market.

The main products that Bangladesh imported from China were refined petroleum (USD 861M), Light Rubberized Knitted Fabric (USD 749M), and Light Pure Woven Cotton (USD 710M). During 1995-2019, Chinese exports to Bangladesh increased at an annualized rate of 14.8 percent. The main products imported by Bangladesh from India were non-retail pure cotton yarn (USD 541M), raw cotton (USD 539M), and electricity (USD 505M). During the last 24 years, India's exports to Bangladesh increased at an annualized rate of 9.27 percent.[40]

Dhaka’s Policy Options and Eventual Policy Stance

Bangladesh has varied and multifaceted economic engagements with major stakeholders such as the United States, the United Kingdom, EU member countries, China, and India. Owing to its desire to maximize its national income and social welfare for its citizens, Bangladesh increasingly behaves like a trading state. It requires access to markets for its exports, an uninterrupted supply of essential raw materials for its export-oriented industries, and a larger volume of investments to grow its economy. Thus, Bangladesh cannot afford to take sides in the era of great power competition as it will imperil its economic interests. Overriding national economic interests dictate Bangladesh’s current stance of geopolitical neutrality on the global stage.

Outcome and Implications

The export figures underscore the vital importance of the U.S. market, in particular, and the Western markets, in general. It is also widely known that there is broad convergence on strategic issues between the United States, the United Kingdom, and EU countries. Bangladesh’s lack of meaningful export diversification means its economic fortunes are inextricably linked to Western markets in the short to medium term. This also implies that Bangladeshi policy planners at the Foreign Ministry must pay greater attention to U.S.-led Western strategic concerns and sensibilities and devise ways to engage them in meaningful dialogues. Such interaction should be aimed at securing expanded and preferential market access comparable to that enjoyed by select African countries under the African Growth and Opportunity Act or Vietnam's preferential trade agreement with the European Union since 2020.

The RMG sector is an example of the effective use of technology transfer and foreign direct investment, and the rise of an adaptive, resilient entrepreneurial class with adequate incentives provided by successive governments since the late 1970s. The nascent entrepreneurial class associated with the RMG sector became the present-day titans of industry who have played a key role in private-sector development. The RMG lobby could act as a quasi-private conduit with concerned entities in the United States and the European Union to explore new avenues of economic engagement.[41] One of the key concerns of the business lobby was the possibility of trade sanctions imposed by the United States and European Union after the controversial elections in Bangladesh on January 7, 2024.

Meanwhile, India and China are important suppliers of raw materials and intermediate products, especially for Bangladesh’s apparel and textile industry. India also remains an essential source of agricultural imports for Bangladesh. In fact, the latter emerged as the top destination of wheat exports from India, having the largest share of more than 54 percent in both volume and value terms in 2020 (Daily Star, 2021). Improved rail and river connectivity has significantly boosted Indian exports to Bangladesh during the COVID-19 pandemic. Bangladesh is also India's fourth-largest export market and the region's largest trading partner.

Bangladesh's foreign policy neutrality claims can be justified to a certain extent by its trading composition and the need to maintain amicable relations with its trade partners. It cannot afford to alienate its major trading partners. The business community of Bangladesh would drive the Bangladeshi government to maintain a course of geopolitical neutrality.

Analysis

Bangladesh's foreign policy approach had been traditionally predicated on the guiding maxim of "Friendship to all, malice to none." However, in practice, since 2014, the government of Sheikh Hasina turned more autocratic and was accused of manipulating and even rigging local and national elections. This, in turn, invited rebuke and criticism from the West, led and spearheaded by successive U.S. administrations.[42] The political consideration of retaining state control at any cost seemed to permeate all layers of government policymaking, along with greater centralization of power in the prime minister's office.[43] The Ministry of Foreign Affairs also started to conduct foreign policy according to the political dictates of the ruling party, as opposed to national interests. Greater reliance and warmer relations were forged with non-Western countries such as India, China, and Russia, which overtly practiced a policy of non-intervention and supported Hasina's government.[44] As successive elections became even more one-sided and controversial, Hasina relied increasingly on the non-Western axis of nations. What helped the Hasina regime was the blossoming of the incipient rivalry between India and China in South Asia. Bangladesh managed to play off both countries and secure concessions. While India was more prominent in bolstering security ties, China increasingly became the source of investment in mega-infrastructure projects, which opened greater opportunities for kickbacks and corruption amongst the upper echelons of the ruling class in Dhaka. Russia also became a conduit for funds. Bangladesh, like several other South Asian nations, benefited from the Sino-Indian rivalry and proudly boasted of adroitly pulling off a tightrope walk.

The context is important to understand how Bangladesh conducted its foreign policy regarding the Rohingya and the Teesta River issues. In both cases, there was an initial attempt to extract the maximum possible advantage without firmly committing to one side. In the Rohingya case, Bangladesh tried to balance the major foreign players' different—and at times conflicting—objectives. The U.S.-led Western bloc wanted Dhaka to pursue the Rohingya issue with Myanmar proactively and to co-opt the Bangladeshi policymakers and the Bangladeshi Government in the process. Meanwhile, China, India, and Russia pressured Bangladesh to take a less aggressive approach and rely on bilateral negotiations or mediation by a third country acceptable to Myanmar and Bangladesh. The balancing approach was soon abandoned, and Bangladesh sought Chinese mediation to resolve the dispute. This bandwagoning was made possible by increased Western criticism of Bangladesh's lack of democracy and China's increasing importance in the Bangladeshi economy.

Similarly, the eventual outcome of the Teesta River was also bandwagoning, where Bangladesh decisively swung in line with India's geostrategic objectives. However, the similarity ends here. In the case of the Rohingya issue, the bandwagoning involved moving away from Western policy alignment to one of the Chinese. However, in the Teesta River case, it was moving away from China to India. Also, Bangladesh's initial stance in the case of the water-sharing dispute was to engage both China and India to secure a better deal. India’s security concerns and close identification with Hasina’s regime meant that Bangladesh had to fall in line with Indian wishes.

Only in terms of trade dynamics and the resulting influence on Bangladesh’s foreign policy is there an attempt at neutrality, with considerable trade engagement with both the Western and Indian and Chinese partners. This was more by default than by design. The export of mainly RMG products at bulk volume has traditionally gone to the United States, the United Kingdom, and EU member nations, while the import of raw materials, intermediate products, and capital machinery and foodstuffs was dominated by China and India. The desire to balance the export and import partners meant that Bangladesh couldn’t afford to rupture ties with these important stakeholders. The business lobby, which in many instances was heavily involved in the export and import of merchandise, formed a key constituent of the decision-making elite of Bangladesh. Many business leaders had entered the parliament as ruling Awami League legislators and exercised some influence on the implementation of Bangladesh’s foreign policy.

Implications

The short-term implications of the foreign policy pursued by the Awami League under Sheikh Hasina are easier to gauge than the long-term ones. In the Rohingya and Teesta cases, the Bangladeshi government failed to achieve its desired objectives. The Rohingyas have not been repatriated to Myanmar, and there is no credible solution to the Teesta River water sharing or joint basin management. The government incurred the ire and wrath of the people of Bangladesh, who, by and large, think that an independent foreign policy reflective of Bangladesh’s priorities and concerns has not been achieved. Relations with India have soured, and Chinese investments are looked at with suspicion. In terms of trade composition, no significant changes in the short term are expected to happen, owing to the inherent composition of the Bangladeshi economy. After the ouster of the Hasina government, the more Western-inclined interim government may carry out significant changes in foreign policy, in particular regarding the Rohingyas and the Teesta River.

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Centre for Governance Studies (CGS)

The Centre for Governance Studies (CGS) strives to advance democratic values, strengthen good governance, and uphold human rights in Bangladesh at a time of rapid national and global transformation. Established in 2004 and developed into a full-fledged think tank by 2016, CGS works to promote transparency, accountability, and inclusive development by bringing together the academic community, government, private sector, civil society, and development partners. Its mission encompasses combating misinformation and disinformation, safeguarding press freedoms, enhancing institutional resilience, and fostering a governance culture that is participatory, evidence-based, and responsive to citizens' needs.

CGS is a non-profit, independent institution governed by a nine-member Board of Directors. Mr. Zillur Rahman provides strategic leadership as President of CGS, with Mr. Parvez Karim Abbasi serving as the Executive Director. The Board includes eminent academics, respected civil society figures, and accomplished private-sector leaders, ensuring both intellectual diversity and institutional integrity.

CGS conducts rigorous research, facilitates high-level dialogues, and convenes multi-stakeholder platforms to generate evidence-based insights on democracy, electoral governance, media freedom, national security, political economy, digital transformation, and citizen engagement. A flagship initiative of the Centre is the Bay of Bengal Conversation (BoBC), now widely recognised as the largest privately convened Track II international conference in South Asia. Held annually for over three years, BoBC brings together global thought leaders, senior policymakers, diplomats, scholars, business executives, and civil society actors to examine the region's most pressing geopolitical and governance challenges. Its scale, diversity, and intellectual depth have positioned BoBC as a unique venue for independent, forward-looking dialogue in South Asia.

Through its research publications, national consultations, international platforms such as BoBC, and public-facing initiatives like Trityo Matra, CGS works to strengthen institutions, broaden civic participation, and promote transparent, accountable, and inclusive governance in Bangladesh.

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Small State Capabilities in Managing Multipolarity:

Case Study of Nepal

Ms. Apekshya Shah

This paper is part of a series of analyses of small-state strategies in navigating large-power competition. The experts were commissioned in Bangladesh, Bhutan, the Maldives, Nepal, and Sri Lanka to produce papers examining how those countries have managed relations between large powers such as China, India and the United States, which are increasingly vying for political and economic influence across Asia.

The papers each examine three case studies that illuminate the strategies small states use to pursue their interests vis-à-vis large powers. In particular, the papers examine the domestic political considerations that shape the countries' actions, an underexplored dynamic in international relations research. A summary paper synthesizes the findings of the country papers and advances macro analysis and findings about the options and limitations for small states to maximize their positions relative to competing large powers.

Introduction

Many studies have examined how small states act and what powers they can employ to achieve their foreign policy goals. This has led to the discovery of strategies like alignment,[1] bandwagoning,[2] and balancing,[3] among others, for small states to secure their interests. Small states have numerous tools to gain and wield power and influence. Some are structural, such as location, geology, and natural resources. Others are flexible, such as political systems and compliance with norms.[4] This makes the pursuit of dynamic and strategic policies feasible. Thus, researchers have tried "shifting the focus from the power that states possess to the power that they exercise," through diplomacy and foreign policy, avoiding the question of power definition.[5] Instead, they analyze small states' behavior case by case using different levels of analysis to examine the strategies they employ to influence asymmetrical relations to secure their interests.

Moreover, especially when geopolitical competition is present, major powers must devote disproportionate time and resources to cultivating and maintaining relationships with small powers.[6] Big power behavior during intense geopolitical competition—which is always present in interstate relations but can vary—shapes small state policies. Thus, all powers—big or small—care about influence in times of heightened geopolitical competition that affects state actions. In this context, studying small-state behavior is especially beneficial for understanding how geopolitics unfolds in different regions. Since China and India went to war in 1961 over territorial disputes, South Asia has been embroiled in a new chapter of an age-old geopolitical struggle.[7] The China-India rivalry shapes the geopolitics of the sub-continent to a large extent. Thus, South Asian small states present an interesting cross-section of global and regional competition among great powers.

One such country is Nepal, the region's oldest sovereign state. Due to its strategic location between China and India, Nepal has a long history of diplomatic practices and experience with geopolitics.[8] Nepal has a bigger population and a larger landmass than Bhutan, the Maldives, or Sri Lanka, and it has enormous hydropower potential, all of which give it significant leverage in South Asia.

Bordered by India on three sides and China on the northern side through the Tibetan plateau, Nepal has been called several things, including a small state, a buffer state, and a landlocked developing country.[9] Thus, due to its landlocked geography and asymmetry with its larger neighbors, Nepal remains a small or weak power regardless of the parameters used to define it.

Nepal is particularly dependent on its neighbors for trade and transit due to its landlocked geography, which puts it between two Asian powers that want to maintain influence in Nepal. Nonetheless, as rival powers—and not just any rivals, but two Asian giants—India and China provide Nepal with options and leverage. The policy options available to smaller states are determined by the impact that their actions can have. For instance, smaller states with nuclear weapons can better negotiate and achieve political aims. However, a state's bargaining power is influenced far more by the availability of alternatives than by its economic and military resources.[10] Thus, Nepal's geostrategic position between China and India presents Nepal with options from different powers during geopolitical competition, giving it room to maneuver. The policy space Nepal creates and the actors it engages determine the options available to the country.

According to the late U.C. Berkeley Professor Leo Rose, Nepal wanted to be a "link" and establish its own identity "to avoid eventual absorption into the Indian mother culture" after opening relations with China in 1954.[11] Nepal's cultural identity, positioned as a bridge between Southeast and South Asia, has influenced its diplomatic stance. The 1962 India-China War dashed Nepal's hopes, and the Indo-Sino War made it a buffer state with competing powers.[12] [13] The mistrust and border dispute between India and China have influenced their regional rivalry. China has retained significant influence in Southeast Asia, whereas India has actively pursued its regional ambitions in South Asia.

The regional dynamics and Nepal's strong social and economic connections with India position Delhi as Nepal's most influential external stakeholder. Nepal's asymmetrical relationship with India renders it susceptible to Indian influence, compelling it to adopt a defensive posture and seek alternatives.[14] Nepal has been adamant about preserving its relationship with China, which is thought to be close enough to provide Kathmandu with support when needed but too distant geographically and culturally to threaten Nepal's independence. India has largely adopted a zero-sum approach to Nepal-China relations, viewing it as a blackmail tactic used by Nepal against India. However, historically, India's overt attitude and perceived threats from Delhi have pushed Nepal to seek alternatives with China. While the limitations of Chinese assistance have been apparent in the past, the rise of China is changing the dynamics in the region and beyond.

Geopolitics appears to be returning to the region because of China's recent economic growth, and the relative calm that followed the Cold War appears to be fading as major powers compete for influence. Nepal also became a republic in 2015, following several changes to the government since 1990. The civil war that began in 1996, the rebels' entry into mainstream politics, the removal of the monarchy in 2008, and the promulgation of the constitution, as envisioned by the peace process, meant that the country had been in political transition for nearly three decades.

During this period, political instability, poor governance, and slow economic growth made Nepal more vulnerable to external shocks and influence. At the same time, interaction and reliance on the international community and its two neighbors have increased significantly.[15] As democratic forces took power and multiple parties and interests focused on Nepal's foreign policy, issues became politicized, hurting diplomacy and foreign policy. Also, political uncertainty has quickly enslaved state actors and institutions, reducing their effectiveness. In this context, the paper explores how small states like Nepal manage the current geopolitics in South Asia.

Methodology

The paper examines three case studies that have been considered in various contexts. The criterion for selecting the first case study was changing government strength—a time when the government was weaker than other times. Nepal's transit agreement with China amid India's economic blockade has been selected as the first case study. The second case study on Nepal-India hydropower cooperation agreements was chosen based on political economy analysis (PEA), especially where domestic power consolidation or elite financial gains are the main drivers. The third case study examines development assistance coming to Nepal through the U.S.-backed Millennium Challenge Corporation. Development assistance was chosen to maintain sectoral diversity from the two cases above.

This analysis will examine Nepal's foreign policy qualitatively. The theoretical aspects of the study will be primarily based on secondary sources, specifically literature on geopolitics and small states in international politics. The theoretical investigation focuses on the strategies used by Nepal. Primary and secondary data will be examined for the case studies. The primary data for the case studies will be gathered through personal interviews with Nepali experts. Secondary sources will largely come from regional publications, including those from Nepal, India, and China. The case studies examine how Nepal has made strategic decisions by creating policy space for itself during periods of geopolitical competition in the region.

Case Study 1

Nepal-China Transit Transport Agreement 2016

Nepal and China signed the historic Transit Transport Agreement in March 2016, but it had been in the works for a year, as Nepal was short on supplies due to a blockade by India. Nepal's economy is closely linked to India's, with both countries sharing an open border and a pegged currency. The blockade dealt a blow to Nepal's economy, which was still recovering after the 2015 earthquakes. India was the only country providing Nepal with transit rights until the agreement was concluded with China. The case study also serves as a foundation for subsequent case studies examined in the research, as it delves into the 2015 blockade and the series of foreign policy decisions made by Nepal, specifically regarding its relations with its neighbors in the face of intensifying geopolitical competition.

The relationship between India and Nepal has experienced a decline since the ratification of Nepal's constitution in 2015. Meanwhile, relations with China have experienced unprecedented improvement.

All that has followed a blockade that Nepal accused India of imposing because Nepal's newly ratified constitution did not satisfy the demands of the Madheshi people, an influential ethnic minority in the southern plains and socially close to India. The Madheshis criticized the constitution for marginalizing them and not addressing their demand for ethnic federalism,[16] and India insisted that Nepal should resolve the status of Madheshis before ratifying the constitution.[17] The Indian government even sent a special envoy, including then Foreign Secretary S. Jaishankar, two days before the ratification to counsel Nepali political leaders to postpone the endorsement.[18] Nepal's Constituent Assembly promulgated its new constitution on September 20, 2015, marking the end of an eight-year drafting process. The Constituent Assembly, representing Nepal's diverse ethnic, religious, and social demographics, ratified the constitution with more than 80 percent of its members.[19] Prior to the document's promulgation, violent protests erupted in the southern plains, resulting in significant casualties.[20] India, expressing its dissatisfaction, simply noted the endorsement and claimed that the constitution lacked sufficient inclusivity.[21] On September 22-23, the Indian government urged Nepal to amend the document to address the grievances of marginalized groups.[22] The diplomatic intervention heightened tensions between the two countries. Furthermore, during his November 2015 visit to London, Prime Minister Modi publicly addressed the issue, prompting the Nepal government to protest the action.[23]

Soon after the constitution was promulgated, goods entering Nepal from India halted. While India maintained that it was due to the protests at the border points, Nepal accused India of imposing an unofficial trade blockade.[24] [25] Nepal viewed India's overt attempts to influence the constitution-making process and blockade as hostile behavior. Nepal ran out of essential supplies within days, causing chaos during post-earthquake recovery.[26] Besides, as was discussed in the Indian parliament, this was not the first time that India had used economic sanctions to achieve its political objectives in Nepal.[27] India has blockaded Nepal four times since the 1950s, including the one in 2015.[28]

Parties to domestic political struggles often reach out to outside powers for support and leverage. India has often been Nepal's external partner due to social and political ties. Given the history of relations between the two nations, India has begun to view itself as largely duty-bound on Nepal-related issues, not knowing when to stop, according to Dr. Bhattari.[29] Aggressive behavior from not only a major power but also a neighbor has caused anxiety among political elites, and anti-Indian sentiment is widespread.[30] After the constitution was adopted, Prime Minister KP Sharma Oli, leader of Nepal's second-largest party, the Nepal Communist Party—United Marxists Leninists, or UML—and a staunch supporter of the constitution, formed the government, which was also dubbed the left alliance. Oli lambasted the Indian blockade in international forums,[31] while relations remained tense because Oli suspected India of conspiring to prevent him from becoming prime minister and vowed not to visit India until the blockade was lifted.[32]

The new government quickly requested fuel from China and signed a historic agreement between the Nepal Oil Corporation and PetroChina to supply Nepal with petroleum products, thus breaking India's monopoly.[33] The UML appeared determined to seek alternatives with China, regardless of the potential consequences of such actions, and the two countries signed the Transit Agreement in 2016.[34] The prime minister and his coalition partners justified their moves by citing non-alignment policy, saying it was for the country's benefit to diversify its trade and transit reliance and improve connectivity with its neighbors.[35] The prime minister's visit to India in February 2016, after the blockade was lifted, demonstrated that the Oli government was equally serious about connectivity with India. Still, the fact that no joint statement was issued after the visit showed that tensions remained between the two countries.[36]

The lack of a long-term economic vision to strengthen Nepal-India relations, poor implementation of India-backed development projects, and untapped hydropower potential have hurt Nepal's economic goals.[37] Delhi's meddling in Nepali politics led many to believe it wanted a weak, controllable state. China, on the other hand, had grown to become the world's second-largest economy and was pursuing an outward-looking foreign policy. Since the blockade had cornered Nepal, turning to China for assistance was the only viable option, no matter how limited it was. For instance, relying on China for fuel during the blockade was impractical due to China's low supply. Also, poor infrastructure and transit routes limited the volume of trade.

Still, the transit agreement opened a policy space for Nepal that was previously unavailable. Northern routes were irrelevant for Nepal until China's rise in the early 2000s. China began developing parts of East and South Asia to create an external environment conducive to its economic growth. China sought to create a "stable periphery" by attracting countries for economic benefits, interdependence, and Chinese benevolence.[38]

By 2013, China launched its Belt and Road Initiative (BRI), a trade and development program along the ancient Silk Road routes between Asia, the Middle East, and Europe. Before signing the transit agreement with Nepal in 2016, China had secured infrastructure deals in Pakistan, Bangladesh, and Sri Lanka, which were later added to the BRI. Along with the transit agreement, Nepal's admission to the BRI—strengthening connectivity and improving land transport infrastructure, including cross-border railways—laid the groundwork for the free trade agreement and energy cooperation dialogue. The Nepali Government also encouraged Chinese investment and financing for development projects.[39] The transit agreement was the most significant and symbolic step in Nepal-China relations, and the countries concluded the implementing protocol in 2018.[40]

While transit protocol negotiations were timely, the results were disappointing, partly because of slow infrastructure development at Nepali border points and the government's failure to encourage traders to use northern points. The COVID-19 pandemic also slowed momentum.[41]

The agreement, however, helped Nepal gain leverage over its southern neighbor. Instead of being just an alternative, it was a way for Nepal to increase its trade and connectivity options. Delhi appeared to have two reactions to the transit agreement: displeasure with Prime Minister Oli for pursuing ties with China and a need to address Nepal's economic issues.

However, the transit protocol with China improved Nepal-India transit and trade. Ravi Sainju noted that after Nepal and China finalized the protocol, India was eager to offer inland waterways for transportation during a 2018 transit meeting and reassess trade and transit issues. Other countries also appeared interested in learning more about the transit arrangement with China as they investigated the possibility of establishing industries in Nepal.

Through the transit agreement, meaningful dialogue with China was possible. Post-2016, Nepal-China relations improved across the board, from politics to the economy.[42] As a symbol of the changing times, President Xi visited Kathmandu in 2019, elevating the relations between the two countries to a strategic partnership.[43] Still, Nepal has not made enough progress in reducing its dependence on India and integrating with China through its policies.[44] Most agreements with China have been characterized as more rhetoric than actionable outcomes. No meeting of the joint mechanism as agreed in the transit protocol has taken place, and the BRI agreement protocol, which Nepal joined in 2017, has not been finalized.[45] Similarly, the country has yet to secure a reserve of petroleum products sufficient to last six months in the event of a supply disruption.

Additionally, the government has not diversified its trade routes with India, and more than 95 percent of Nepal-India trade occurs through only two border points. Nepal is still heavily dependent on India for essential commodities and economic trade despite economic blockades almost every other decade since the 1960s.[46]

At the same time, Delhi has vetoed Chinese investments in Nepal if it is to participate in those projects. For example, India has so far refused to grant permission for the operation of the two international airports in Nepal that were built with Chinese assistance, and it also refuses to purchase hydropower that has been developed through Chinese investment.[47] However, as previously stated, closer relations with China resulted in a positive economic response from India, and significant improvements in connectivity between Nepal and India occurred after 2016.

Still, India is worried about losing influence in Nepal. According to one analyst's assessment, after supporting the political movement against the King in April 2006, India believed the monarchy had always played the China card and that Maoists and other key parties would be a better experiment without it.[48] Also, India believed it would lead Nepal's politics for a long time. Both proved wrong in 2015. Furthermore, India was wary of the BRI and China's growing presence in the Indian Ocean and South Asia. It was especially vocal about the China-Pakistan Economic Corridor.[49]

Strategy Applied: Hedging

Nepal has long recognized its limitations in exercising autonomy amid regional power asymmetries. Yet, engagement with great powers has afforded Nepal policy space to explore alternatives.[50] As Womack notes, "Autonomy and deference are complementary in a normal asymmetric relationship, which is negotiated between unequals."[51] While larger powers benefit from shared interests in such relationships, smaller states like Nepal can use them to assert agency and pursue change.

Nepal's age-old pursuit of relations with China, supported by its non-alignment policy during the Cold War, reflects this approach. Two key goals—ensuring Nepal's territory is not used against its neighbors and preserving foreign policy independence—have made non-alignment a cornerstone of its foreign policy and enabled it to hedge between two neighbors. For smaller states, hedging is a strategic tool: rather than fully aligning with any single power, they maintain relationships with multiple actors to reduce dependency and increase flexibility.

This was evident during the 2015 blockade when Nepal's political elite called for reducing dependence on India—similar to responses during earlier blockades. Yet, it is noteworthy that there are currently no substantial policies being enacted to alter Nepal's long-standing dependence on India. This has repercussions for Nepal's relationship with China because it may convey signals about the country's continued reliance on India, which Nepal might not want to give up. Thus, Nepal's engagement with China is not a strategic shift but a pragmatic effort to counterbalance India's dominance. This reflects a textbook hedging strategy: Nepal is not choosing sides but carefully managing ties with both powers to preserve autonomy and advance national interests within a structurally asymmetric environment.

Similarly, the 2016 Transit Agreement with China helped Nepal balance India's influence and deepened engagement with Beijing. While Nepal has historically turned to China to counterbalance India, Beijing's influence has been limited due to geographical barriers, cultural differences, and China's broader foreign policy priorities. Still, Nepal's China policy—often dubbed the "China card"—is less about countering India outright and more about creating strategic options in response to the threat that Nepal sees emanating from India.[52] Despite growing Chinese engagement, India remains Nepal's primary partner, and the notion that Nepal is actively pivoting away from India is overstated. China, at least in the near future, does not present a viable alternative.

Nonetheless, Nepal's most significant asset in fostering relationships with China is its vulnerability. Nepal lacks the capacity to influence the power dynamics between India and China. Nepal's independent foreign policy involves fostering relationships with both sides of the balance of power to facilitate economic development. This makes sense, given that the development of Nepal's economy does not threaten to upset the power dynamic between India and China. The balancing policies of smaller powers, however, are dangerous because great powers support weak states to improve their standing in relation to other great powers. India believes this regarding Nepal-China relations. India has accused Nepal of being ungrateful for its special relations and calling its balancing policy blackmail.[53] Implementing balancing strategies may lead to political tensions and unintended consequences for smaller powers, potentially resulting in the loss of economic benefits if the larger power responds with punitive measures. As previously noted, Nepal is especially exposed to India's sanctions.

The transit agreement with China has enabled Nepal to assert some independence and enhance its bargaining power in relation to Delhi, leading to concessions in connectivity projects. However, India remains cautious of the increasing Chinese influence in Nepal, particularly in light of China's expanding presence in South Asia. China's diplomatic relationships with all South Asian countries are increasingly influencing its strategic objectives, thereby impacting the balance of power with Delhi. Thus, Nepal must be aware of Indian concerns about China's rise and keep in mind that balancing can be costly. Furthermore, Nepal might not have as much agency as it believes. The possible liberalization of India's trade and transit policies, because of the transit agreement, could be influenced by Nepal's agreement with China or by China's attempts to reduce Nepal's historical dependence on India. Thus, the two powers may equilibrate independently without Nepal needing to engage significantly in balancing efforts.

Case Study 2

Nepal Hydropower

Nepal has always tied its hopes of economic growth to selling hydropower to India and often has had to bandwagon with India to gain from its market. Nepal's 1990s hydro dream was dominated by foreign expertise and used a top-down approach that viewed hydroelectricity as a commodity to be exported rather than a primary input to domestic production.[54] Since Nepal could generate so much hydropower but consume little, the assumption was that the surplus should be exported to generate government revenue. This plan required massive investment, expertise, and the right environment. Post-Cold War liberalization and privatization were introduced to address concerns with landmark policies on the sector: the 1992 Hydropower Development Policy (HDP), Water Resources Act, and Electricity Act, which supported private power sector investment.[55] The early 1990s were promising, but the restoration of multi-party democracy and vibrant civil society politicized water and hydropower. The 201-megawatt World Bank-led Arun-3 1994 and the Mahakali Treaty 1996 were particularly controversial.

The 1990s boom added 268.7 MW between 1997 and 2002, meeting 91 percent of the government's goal. The Nepal Electricity Authority (NEA), the government-owned utility responsible for electricity generation, transmission, and distribution, failed to add a single MW between 2002 and 2007, while the private sector added 33.93 MW, meeting only 10.78 percent of the government's target.[56] Nepal's civil war cost the country critical years, and when its regime changed in 2008, political actors again became interested in the hydro sector. That coincided with power shortages in the country due to rising demand, which peaked in 2016 with up to 18 hours of power cuts in the winter dry season. The interim Nepali government licensed Indian companies Satluj Jal Vidyut Nigam (SJVN) and GMR Group to develop attractive hydropower sites like the Arun-3 and the Upper Karnali, respectively, for exporting electricity to India. The decision to grant licenses to Indian companies was made in hopes of gaining access to the Indian market and determining the commercial value of Nepal's generated power.[57] The arrangement gave Nepal a market for its excess power and India lucrative hydroelectric dam construction contracts. To improve power exchange with India, the government also decided to build Dhalkebar-Muzaffarpur cross-border transmission lines financed by Indian companies.

However, India's two projects were not kicked off until 2014, when Prime Minister Modi signed a power development agreement for Arun 3 and Upper Karnali. A market for Nepali power in India was opened as well in 2014 by the historic Power Trade Agreement (PTA), which allows licensed producers to trade electricity in India.[58] This development was significant because it is commonly held that Nepal's hydropower cannot be developed sustainably without an export market to India. Nepal generates three times as much electricity during the four-month wet season as during the eight-month dry season, which has been an ideal situation for trade with India because India requires more power during the wet season, and in the dry season, when Indian demand decreases and power prices fall, Nepal can import if necessary.[59] The Indian government also approved the establishment of a regional power exchange to help SAARC countries develop their power markets, signaling a move toward liberalizing electricity trade in the region.[60] However, the 2015 blockade soured relations between the two countries, ending the celebrations.

Since 2016, India has imposed restrictions on the energy it imports from its neighbors.[61] In the case of Nepal, this clearly aims to restrict Chinese investment in the hydro sector. The Guidelines for Import/Export (Cross Border) of Electricity by India's Power Ministry only allow Indian entities to import electricity from companies that do not have any links to China.[62] India's zero-China policy makes it difficult for Nepal to legally discriminate between countries that want to invest in Nepal, but it does hinder Chinese investment. India seemed to have two strategies to maintain its influence in Nepal's power sector: import conditionality for its growing energy market to discourage Chinese investment and increase bilateral cooperation.[63]

Nepal's political elites have also shown renewed interest in boosting electricity trade with India to repair relations and maintain exports to Indian markets since 2015. To reconcile with India, Prime Minister Oli gave the Lower Arun hydropower license to an Indian company without bidding.[64] Oli's decision to give SJVN Lower Arun was wise politically and economically. The Lower Arun was a natural extension of SJVN's Arun 3 cascade, awarded in 2008, and the benefit-sharing arrangement, which includes 21.9 percent of the electricity generated from both projects going to Nepal for free, including royalties, was a bargain.[65] In 2021, the project was awarded as the country produced a surplus in the wet season, and the completion of the Dhalkebar-Muzaffarpur cross-border transmission lines allowed exports in the wet season.[66]

India opened its day-ahead power exchange market for Nepal to sell electricity developed with Indian assistance in 2021, and since 2023, Nepal, Bangladesh, and Bhutan can trade in India's Real-Time energy market.[67][68] Along with its intentions to invest in hydro projects in Nepal, Bangladesh has been investing in hydro projects in Bhutan, and India has also authorized Nepal to export 40 MW to Bangladesh via Indian transmission lines.[69] India appeared to shift regional cooperation to BBIN, a subregional grouping of Bangladesh, Bhutan, India, and Nepal after a diplomatic rift with Pakistan slowed the South Asian Association for Regional Cooperation.[70] Since India separates the three BBIN countries, geopolitical disputes between India and Pakistan do not affect these countries, which are geographically adjacent, giving India the chance to lead regional initiatives that resonate with the aspirations of its smaller neighbors—as Bhutan, Nepal, and Bangladesh have consistently advocated for enhanced regional integration.[71] It is also possible that India is trying to undermine Beijing's sway in South Asia and set the stage for future energy liberalization in South and Southeast Asia by endorsing regional power exchange.

India has also been gradually increasing its imports from Nepal through bilateral agreements and has committed to importing 10,000 MW in a landmark long-term power agreement signed by the two countries in 2023.[72] The agreement allows for long-term and medium-term contracts. In the most recent development, India has opened a new and third market for Nepal by allowing Indian distributors to include imported hydropower in the renewable energy quota required by the Renewable Purchase Obligation policy, a critical initiative launched by the Indian government to promote renewable energy. According to estimates, up to 522MW has been cleared for sale in India's exchange market, including day-ahead and real-time markets for Nepal in 2023.[73] Electricity trade between Nepal and India has increased from 39 MW approved by India in 2021 to more than 700 MW in 2024.[74]

Nepal has unprecedented access to India's energy market and increased electricity supply, but India refuses to purchase electricity from the 456 MW Upper Tamakoshi project, which was funded by Nepali domestic investment but used Chinese civil contractors.[75] Developers complain that India's strict power import approval process and requirement that companies disclose all project documents seem to dictate what can be built in Nepal. With India's conditionality, Nepal's political elites have understood the geopolitics of the hydro sector.[76] Oli gave lower Arun to India. The Nepali Congress took over in 2022, and Sher Bahadur Deuba became Prime Minister. Deuba accelerated Indian company projects after becoming prime minister. Another Indian state-owned company, NHPC Limited, received West Seti and Seti River-6,[77] while SJVN once again received 51% of Arun 4.[78] The West Seti reservoir project had stalled for 20 years because India opposed buying power from plants that had received investment from Australia and China.[79] Since 2016, Chinese companies have canceled many projects, including the Tamor Hydropower project agreed upon during President Xi's visit to Nepal.[80]

The rapid transfer of hydropower projects by executive decision has drawn criticism and suggests political calculations. Critics argue that the parliament should discuss critical natural resources like water, which political actors have avoided by exploiting an Investment Act loophole.[81] Poor project management has made it harder to attract investors in a volatile geopolitical environment. In 2017, the Nepali Maoists awarded the 1,200MW Budi Gandaki power project to the Chinese company Gezhouba Group without bidding. A few months later, the Deuba-led Nepali Congress government revoked the award. The left-alliance government under Oli awarded the project to Gezhouba again in 2021, but the Deuba-led government revoked it in 2022.[82]

Indian policy has hindered Chinese investment in Nepal, putting many projects at risk, including BRI ones, and preventing Nepal from using Chinese funds and expertise. India's proposal makes geopolitical sense because buying electricity built with Chinese help in Nepal increases Chinese influence, which India doesn't want.[83] The main issue in Nepal is not preventing Chinese investment but rather India's attempts to micromanage the sector's development and dictate export-oriented projects.[84] According to one analysis, the World Bank, which had expressed interest in financing Upper Arun's development, has gone silent in response to India's disapproval.[85] India wants to build Upper Arun itself, reports say. However, India-backed companies funding Upper Arun projects near China will cause geopolitical tension. According to government plans, five river projects have been surveyed: Kimanthanka Arun; Upper Arun, which Nepal wants to build and was proposed for World Bank financing; Arun 4, which Nepal and India are building together; Arun 3; and Lower Arun, which India is developing.[86]

After years of improvement, Nepal has connected 99 percent of the country and become an electricity exporter in 2023–24. Nepal's total electricity production capacity is 3,157 MW, with a peak demand of 2,467 MW.[87] However, only approximately half of this capacity is generated during the winter season, leading to a surplus in the wet season and a continued reliance on imports from India in the dry season. During the rainy season, Nepal sends 700 MW of power to India, but 600 MW of surplus energy is wasted because it does not meet Indian import requirements.[88] Given that the average Nepali consumes only 325 kWh of electricity annually—far below the global average of 3,180 kWh per capita—claims of Nepal having surplus energy warrant scrutiny.[89] Furthermore, because the country was experiencing load shedding until 2018, there has been little industrial consumption. The low domestic consumption suggests that what is termed 'surplus' may result more from limited internal demand rather than genuine excess production. Thus, power trade agreements with India have drawn criticism. India-backed project delays, contentious water agreements, and importing procedures are of concern.

Indian-backed companies have secured nearly 4,600MW of combined capacity nationwide, and 80 percent of bilateral electricity exports in the next decade will come from those companies.[90] Fears that India wants Nepal's water rather than electricity are also widespread.[91] Mainly, concerns exist that hydro sector development is being viewed solely from an export perspective, with little discussion of increasing domestic demand to revive Nepal's economy.

Strategy Applied: Bandwagoning

The preceding discussion indicates that Nepal has opted to align with India in the hydropower sector, primarily to leverage advantages from India's electricity market. The demand for affordable, clean energy is increasing in India. Despite India's significant hydropower production and consumption, Nepal's primary and largest export market remains India, as China does not import power from Nepal. Opportunities for regional power integration have also been made possible by power exchanges with India. Nepal's bandwagoning with India is aimed at securing economic benefits instead of facing costs, which contrasts with the strategy of balancing. Although Nepal has gained access to the Indian market and beyond, there is still a long way to go before it can turn a substantial profit.

Development of hydropower in Nepal should be pursued for reasons other than trade with India. Nepal's reliance on India renders it vulnerable when forming alignments with India in a critical sector, as demonstrated in the initial case study. The political elites of Nepal have used hydro agreements to gain favor with India, overlooking the opportunities for domestic development. Aligning with India could provide immediate benefits for Nepal; however, it is crucial to evaluate the potential long-term implications to prevent adverse consequences. Considering the prevailing geopolitical dynamics, India aims to limit Chinese influence in Nepal, and one strategy employed is to obstruct China's involvement in Nepal's energy exports. It demonstrates the power India has as the only importer and the dangers it poses to significant hydropower projects in Nepal that are being developed for export.

The threat holds validity when electricity is exported to India; however, it diminishes if the electricity is utilized domestically or exported elsewhere. Furthermore, as noted previously, regional initiatives may serve as a viable solution to this predicament, as India can limit Nepal's interests, but it cannot simultaneously suppress the interests of Bhutan, Bangladesh, and Nepal. As a result, smaller South Asian nations possess the opportunity to collaborate to counterbalance Indian influences and advance a more liberalized regional electricity market.

Case Study 3

The MCC Compact Nepal

The Millennium Challenge Corporation (MCC) is an independent U.S. government agency that aids developing nations in economic growth to reduce poverty. The Executive Office of the President and Congress directly oversee it. The George W. Bush administration established the MCC in 2004 amid widespread skepticism about aid's efficacy, mostly due to donors funding unprofitable activities and investments. Development partners struggled to justify and analyze cost-effective activities, and aid-receiving countries had no ownership. In this context, the United States created the MCC to ensure aid effectiveness and fund only projects expected to increase local income by more than the implementation costs.[92] Countries were required to compete for MCC conditional aid, with host governments fully participating in this bipartisan, transparent initiative. The recipient country would "own" the project and assign a ministry or senior official to coordinate the development of a compact agreement—akin to an international treaty—and project implementation.[93]

Nepal knew about the Bush administration's plan to increase U.S. grants to developing countries, and once the MCC was formed, Nepal began talking about joining. In 2010, Nepal began formally applying for the grant.[94] The MCC Board chose Nepal after it passed the scorecard-based eligibility criteria, and Nepal started developing its threshold program in 2012. Nepal's Ministry of Finance, particularly the foreign aid division, led the initiative and began developing support options with the MCC.[95]

The threshold agreement with the MCC was completed in 2014, and Nepal's finance minister and the MCC signed the final agreement for USD 500 million to support Nepal's power and transportation projects in 2017. The government of Nepal chose to pledge an extra USD 130 million as a sign of its dedication to the MCC partnership.[96] This was the biggest upfront contribution ever made by any partner government in MCC history. Energy sector projects included high-voltage power lines, along with a cross-border transmission line with India. The project aims to increase domestic electricity consumption by improving grid availability and reliability and exporting surplus electricity to India to boost government revenues. Nepal and the MCC also agreed to a road maintenance project to maintain road quality nationwide.[97]

The MCC compact required recognition as an international accord governed by international law, facilitating its efficient execution as the project needs to be implemented within five years. While the compact states that it will supersede Nepal's domestic laws in Provision 7.1, experts emphasize that this only applies to conflicting laws, of which there were none. However, Provision 7.2 of the Nepal MCC compact required a signed legal opinion from a government legal representative acceptable to the MCC before the compact could be implemented. As instructed by the compact,[98] a legal opinion was sought, and the agreement was sent for ratification as per the Nepal Treaty Act, as the agreement prevailed over domestic laws in conflict.[99] [100]

The MCC compact was first tabled in parliament for ratification in 2019.[101] Initially presented as a development partnership, the process later became politicized after a U.S. State Department official stated that the MCC was part of the Indo-Pacific Strategy—a broader U.S. policy aimed at promoting security, economic growth, and political stability in the Indian and Pacific Oceans.[102] The United States launched the strategy in 2017, declaring its intent to protect Asia from Chinese aspirations. The strategy emphasizes military maritime patrols and regional prosperity through economic efforts. The 2019 report, "A Free and Open Indo-Pacific," states that all nations, large and small, should be secure in their sovereignty and able to grow economically in accordance with international rules, norms, and fair competition.[103] It also seeks regional cooperation and sustainable, private-sector-led development through USAID and the MCC.

Left-leaning political leaders criticize the MCC compact as a tool of U.S. geopolitical strategy, arguing that it serves to counter China and could lead to a military alliance under the Indo-Pacific Strategy.[104] The strategy was controversial because it mentioned Nepal, and the United States emphasized it in Nepal relations. The misunderstanding in Nepal stemmed from a lack of clarity about the strategy's purpose. The Indo-Pacific Strategy was not a call to join; rather, it was the driver of U.S. foreign policy in the region, in which Nepal was perceived as playing a critical role.[105] There were concerns that the United States was attempting to involve Nepal in its strategy against China, and the economic assistance was perceived as a response to Beijing's BRI.[106] The Nepal government also clarified that it has not agreed to join any U.S. initiative and had not been asked to. Damage, however, was done.

As the MCC Compact was scrutinized, many questions arose about its provisions. Apart from the Indo-Pacific Strategy, many issues were debated, including whether the document was above the constitution, MCC officials' immunity from Nepali laws, auditing, and intellectual property rights.[107]

Senior left-aligned politicians began speaking out against the agreement and lobbying against its ratification, polarizing the country.[108] Misinterpretations and misinformation complicated the issue further.[109] The prime minister attempted to ratify the agreement by the first deadline but failed, leading to diplomatic tensions between Nepal and the United States.[110] The compact was in the works for years, and all political parties across five governments had worked to advance it. The MCC compact was Nepal's largest bilateral development partner grant, so its failure threatened the country's international credibility.[111] As one of Nepal's oldest allies, the United States has provided economic, social, and security aid since 1947.

The U.S. government firmly stated that amending the agreement was not feasible, but it was ready to address any concerns raised by Nepal's government. The U.S. government responded to the issues raised by the Nepal government, assuring it that the MCC predated the Indo-Pacific Strategy, that the MCC Compact did not allow Nepal's resources to be used for military purposes, and that the agreement was not superior to Nepal's constitution.[112] In addition to clarification, high-level U.S. visits ensured no miscommunications. To break the political impasse in Nepal, the MCC compact and an interpretive statement based on U.S. responses were eventually presented in parliament.[113] This was necessary because the Maoist leaders who had opposed the compact were now part of a coalition government and needed to assuage public concerns and save face.[114] After much delay, parliament ratified the MCC compact and the interpretive declaration in February 2022, days before the U.S. government's second deadline.

The episode demonstrated to Nepal how geopolitics were altered by U.S.-China competition. Due to the expected involvement of nations like India and others on China's periphery, the Chinese government opposed the Indo-Pacific Strategy from the beginning.[115] China also worries about the strategy's military focus and claims the United States is playing a zero-sum game with China in the region. According to the Chinese foreign minister, the United States is "provoking China on issues concerning China's core interests" and taking steps to form small blocs to suppress China.[116] Meanwhile, U.S.-India relations have improved over the last decade, and the strategy has placed a high value on India's role. While India's history can be described as a series of cautious alliances that maintain autonomy while not acquiescing to other major powers, the development of the U.S.-India partnership has been significant on the security front, and it would not be incorrect to argue that India has been inclined to align with the United States, particularly in complementary initiatives to counter the rising Chinese influence that India views as a threat to its security and regional ambitions.[117]

Nepal joined the MCC before the Indo-Pacific Strategy, but its adoption by the United States in 2017 caused controversy. China strongly opposed the MCC, and Nepali politicians seemingly opposed it at China's request. The United States has claimed that China actively promoted a disinformation campaign against the MCC in Nepal.[118]

The United States had also indicated a willingness to reevaluate its diplomatic ties with Nepal should the MCC be dismissed.[119]

The evidence presented in various case studies indicates that Nepal's relationships with its long-standing allies are experiencing strain as a result of increasing regional competition. The escalating geopolitical competition, coupled with Nepal's evolving foreign policy landscape, necessitates thorough deliberation on every foreign engagement. This dynamic places considerable pressure on the government and policymakers to exercise awareness and avoid impulsive decisions. During this period, the MCC and diplomatic ties with China were subjected to a great deal of scrutiny.

Strategy Applied: Hedging

When big powers compete, small states have to navigate several asymmetrical relationships, as the MCC compact case demonstrates. The state must hedge its bet, as Nepal seems to be doing, if it does not wish to align with any major power. Nepal's diplomatic endeavors and foreign policy have consistently emphasized the systematic management of great powers, necessitating collaboration with various actors to fulfill its objectives. States have the capacity to circumvent the dilemma of balance, bandwagoning, or neutrality by adopting a hedging strategy.[120] When a great power's power is uncertain, smaller states hedge by betting on multiple positions to protect against unfavorable outcomes. Smaller states try to avoid becoming too dependent on one great power.[121] Southeast Asian states have successfully used indirect balancing to give regional powers like Japan a stake in the regional order, engage in complex political, economic, and strategic engagement with China, and counter Chinese regional influence by fostering U.S. ties. The aim is to shift the emphasis of regional rivalry from considerations of power dynamics to matters concerning the balance of influence.

The strategy of non-alignment throughout the Cold War allowed Nepal to broaden its alliances and reduce reliance on its neighboring nations. The policy's two main objectives—preventing the use of Nepal's territory against neighboring countries and attaining foreign policy autonomy—constitute a fundamental aspect of Nepal's foreign policy. Nonetheless, escalating geopolitical tensions threaten its viability. The military aspects of the Indo-Pacific Strategy faced significant criticism due to concerns that Nepal's involvement in a military alliance might damage relations with its northern neighbor. This element is also essential to hedging, a tactic used by smaller states to steer clear of aligning their security interests with those of a larger power.

A notable element influencing the concern in Nepal was China's reaction to the Indo-Pacific Strategy. China exhibits little concern over India's relationship with Nepal, but the deeper tie between Nepal and the United States causes anxiety for Beijing. China's apprehensions are heightened by the potential collaboration between the United States and India aimed at curbing Chinese influence. Therefore, if Nepal seeks to safeguard its interests with all its allies, it must adopt a calculated approach to fostering bilateral relations through diplomacy and negotiations. All significant nations will engage in geopolitical considerations when interacting with Nepal. Thus, it is imperative for the country to understand its priorities and advantages. Since 2015, geopolitical competition in the region has complicated Nepal's multiple asymmetrical relationships. All powers—including Nepal—are concerned about influence in Nepal.

Conclusion

Nepal, characterized by its small size and vulnerability, has historically acknowledged its constraints in asserting autonomy in relation to major powers. Engaging them has, however, allowed Nepali policymakers policy space in times of challenges. The three case studies above also reflect that. The study identifies three instances in which Nepal had to evaluate its policy options in light of increasing geopolitical rivalries. The policies ultimately implemented were not the result of well-structured strategies but rather tactical responses to the challenges encountered.

Nepal demonstrates significant vulnerability to external shocks and pressures, primarily due to its internal political instability and economic limitations. Nepal's small-state status means it can generally interact with various powers without being perceived to have any ulterior motives. Nepal-India relations have endured challenges, yet Nepal's reliance on India renders it vulnerable to pressure from its southern neighbor. The emergence of China and its objective to contest India's influence in South Asia has significantly transformed the geopolitical landscape, positioning China as a viable alternative for the smaller South Asian nations.

The initial case study reveals that, despite Nepal's expressed intent to recalibrate its strategic dependence on India, this ambition has not translated into effective policy initiatives. This policy inertia can be attributed not only to a lack of domestic political consensus and commitment but also to the structural constraints imposed by Nepal's asymmetric relationship and deep-rooted economic interdependence with India. Consequently, Nepal's capacity to reduce Indian influence remains constrained by both internal and external factors. Still, the power dynamics between its two neighbors compel them to seek influence over Nepal, thereby providing Kathmandu with alternatives to safeguard its interests. Additionally, since the two powers may balance themselves, Nepal may not need to exert much effort. Furthermore, the balancing behavior of these regional powers may inadvertently reduce the urgency for Nepal to actively pursue aggressive foreign policy shifts, allowing it to navigate its geopolitical challenges with a degree of tactical flexibility.

The second case study illustrates that, given its ample water resources and hydropower potential, Nepal has aligned itself with India in pursuit of revenue generation through power exports. The fact that India is the sole market for Nepal has provided India with considerable leverage, which it has strategically employed to hinder Chinese investment in Nepal's power sector. Simultaneously, India is advancing significantly in its efforts to purchase and establish a dependable market for Nepali power. The regional initiatives endorsed by India represent a significant development, indicating that if Bangladesh, Bhutan, and Nepal collaborate effectively, they may press India to adopt a more liberalized approach to the regional energy market. Hydro development in Nepal must prioritize not only export potential but also the promotion of domestic growth.

The political elites appear to leverage hydro projects for diplomatic gains with neighboring countries, yet there seems to be a lack of a comprehensive strategic framework for sector development. In the situation concerning China, Beijing will continue to be at a disadvantage until it begins to import power from Nepal.

The MCC case came at a time of heightened politicization of foreign policy in Nepal. As a result, the implementation of the compact quickly became enmeshed in controversies. The compact, which Nepal ratified in March 2022, nearly four years after it was introduced in parliament, symbolized the polarized state of Nepal. Nepal needs to adjust to the new reality of heightened geopolitical competition after the relative calm of the post-Cold War era. The search for common ground amongst rival powers is increasingly challenging, especially considering the recent strategies adopted by larger powers. Nevertheless, the present geopolitical landscape is characterized by a multi-polar structure, with power dynamics exhibiting greater intensity and interdependence than during the Cold War, leading to rapid shifts in strategic calculations. As was indicated in the last case study, smaller powers need to manage and navigate big power rivalries strategically.

Nepal's non-alignment policy requires a revision to align with contemporary realities, similar to the adjustments made by nations like India. Strategic partnership and strategic autonomy represent contemporary variations of realpolitik, enabling states to engage in a pragmatic evaluation of their interests and make decisions that align with their objectives. Strategic behavior is a newer type of non-alignment policy in which the country seeks alignment on an individual issue basis. Strategic engagement involves the thoughtful process of addressing issues that are in alignment while simultaneously negotiating or countering those that are not congruent. To achieve this, Nepal must initially endeavor to clarify its foreign policy priorities through a comprehensive analysis and thoughtful discourse. Negotiations and diplomacy will be crucial in Nepal's bilateral relations with major powers, but a broader comprehension of how geopolitics is developing is also essential.

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Small State Capabilities in Managing Regional Power Rivalries:

Case Study of Sri Lanka

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This paper is part of a series of analyses of small-state strategies in navigating large-power competition. Experts were commissioned in Bangladesh, Bhutan, the Maldives, Nepal, and Sri Lanka to produce papers examining how those countries have managed relations between large powers such as China, India, and the United States, which are increasingly vying for political and economic influence across Asia.

The papers each examine three case studies that illuminate the strategies small states use to pursue their interests vis-à-vis large powers. In particular, the papers examine the domestic political considerations that shape the countries' actions, an underexplored dynamic in international relations research. A summary paper synthesizes the findings of the country papers and advances macro analysis and findings about the options and limitations for small states to maximize their positions relative to competing large powers.

Introduction

Conventionally, in International Relations (hereafter IR), the concept of "small states" is characterized by low population, land area, production levels, wealth and economy, and military capabilities.[1] A small state cannot be defined only by geographic size or population, but by the ability to project power externally or shape regional and global outcomes independently, often relying on diplomacy, strategic partnerships, and multilateral frameworks to protect its interests. Additionally, a most interesting feature of a small state is its vulnerability and susceptibility to external influences, which provides it with little opportunity to ensure its autonomy and survival.[2] As such, small states are often forced to choose sides and ally with more influential actors to survive in the anarchic international system. This shows the reality of the asymmetry between these small states and greater powers in navigating world affairs.[3]

In an increasingly multipolar world, small states often find themselves navigating complex geopolitical landscapes shaped by the interests of regional and global powers.[4] For small states, managing these external pressures is essential for maintaining sovereignty, economic stability, and diplomatic independence.[5] Sri Lanka, located in the heart of the Indian Ocean region, presents an important case for understanding how small states respond to regional power rivalries. Its geographic location and its strategic importance for trade routes and sea lines of communication have made it a focal point for competing interests, particularly between China and India.[6] This study explores Sri Lanka's capabilities in managing these rivalries while balancing its development needs and political interests.

Sri Lanka, with its population of nearly 22 million and a GNI per capita of around USD 3,540, presents a compelling case of how small states manage great or large-power rivalries. On one hand, Chinese investments have contributed to vital infrastructure development in Sri Lanka; on the other, they have burdened the country with significant debt and heightened concerns over economic dependence.[7] Simultaneously, maintaining strong relations with India is essential, given the geographic proximity and deep cultural connections.[8] Navigating these power rivalries is further complicated by Sri Lanka's economic and governance vulnerabilities, including political instability, corruption, and weak institutional frameworks. These issues undermine the country's capacity to exercise strategic autonomy, making it difficult to balance competing interests, safeguard sovereignty, and foster sustainable economic partnerships. Sri Lanka's approach to balancing these complex relationships offers important insights into the broader challenges that small states encounter when managing competing interests from larger powers.

Sri Lanka's engagement with China's Belt and Road Initiative (BRI) reflects the complexities of managing such rivalries. As part of the BRI, two highly controversial projects, the Mattala Rajapaksa International Airport and the Lotus Tower, were launched. The Mattala Rajapaksa International Airport (MRIA), located in the southern Hambantota district, was built with a Chinese loan. However, it has since been criticized as an example of wasteful spending, with the airport remaining largely non-operational due to a lack of demand. Analysts contend that the project was primarily aimed at bolstering the political influence of the Rajapaksa family within their constituency, rather than addressing a genuine national need, placing an undue debt burden on Sri Lanka.[9] The Lotus Tower, a telecommunications and entertainment hub in Colombo, similarly exemplifies misplaced priorities.[10] While the tower stands as a symbol of modernization, its utility has been questioned given Sri Lanka's more urgent socioeconomic challenges. Both projects highlight small states' vulnerabilities when engaging with major powers, where domestic political agendas and external investments can intertwine, leading to suboptimal outcomes.

The Eastern Container Terminal (ECT) at Colombo Port illustrates Sri Lanka's ongoing challenges in navigating competing external interests.[11] Initially, Sri Lanka entered into a tripartite agreement with India and Japan to develop this strategically significant terminal jointly.[12] However, under pressure from local trade unions and nationalist groups, the government withdrew from the agreement in 2021, opting to pursue independent development of the terminal.[13] This decision strained diplomatic relations with India and Japan, raising concerns about Sri Lanka's reliability in fulfilling international agreements.[14] The ECT case highlights the complexities of managing external partnerships, particularly when domestic political considerations intersect with foreign policy commitments.

A similar challenge arose with the Trincomalee Oil Tank Farm, a colonial-era facility of considerable strategic significance due to its proximity to Trincomalee Harbour.[15] Following prolonged negotiations, Sri Lanka agreed to lease part of the complex to the Indian Oil Corporation. However, the agreement sparked opposition from segments of the public and political actors, raising concerns about potential compromises to Sri Lanka's national sovereignty.[16] The Trincomalee Oil Farm case highlights the delicate balancing act small states often need to perform. While external partnerships can provide economic advantages, they often invite heightened public scrutiny and risk exacerbating geopolitical tensions.[17]

The study of Sri Lanka's management of regional power rivalries contributes to the broader scholarship on small state diplomacy and strategic decision-making.[18] It highlights the complex interplay between domestic and international factors that influence policy choices. Sri Lanka's experience underscores that for small states, economic partnerships with larger powers can provide opportunities, but they also come with significant risks. As such, small states must develop capabilities to manage these relationships effectively, ensuring that foreign investments align with long-term national interests and do not undermine the sovereignty or economic sustainability of the state. This research aims to provide a nuanced understanding of Sri Lanka's strategic choices and draw lessons relevant to other small states facing similar geopolitical challenges.

Methodology

This research employs a qualitative methodology, drawing on neoclassical realism, constructivism, and political economy analysis as theoretical frameworks. It examines three case studies with contextual analysis, approached from a critical perspective to evaluate the country's geopolitical strategies. Primary data is collected through interviews with four experts: These qualitative insights are integrated to offer a comprehensive analysis of Sri Lanka's diplomatic, political, and economic strategies in managing great power rivalries in the South Asian region. The research was conducted through a neoclassical realism lens, incorporating constructivist aspects to elaborate on the evolving presence of major powers in the region and Sri Lanka over the years.

Case Study 1

Belt and Road Initiative Projects of Mattala Rajapaksa International Airport and Lotus Tower

Rival Power Interests in the Project

Sri Lanka's involvement in the BRI has drawn heightened geopolitical attention, primarily from regional rival India, which views China's increasing influence in South Asia with suspicion.[19] China's strategic presence in Sri Lanka, particularly in infrastructure projects with potential dual-use applications, civil and military, has intensified competition in the region.[20] The Mattala Rajapaksa International Airport (MRIA), located near the key Hambantota port leased to China for 99 years, exemplifies how infrastructure investments can provoke geopolitical anxieties.[21] Indian officials have raised concerns that China's activities in Sri Lanka could threaten regional security by granting Beijing leverage over critical maritime chokepoints. Several interviews revealed that India perceives projects like MRIA and the Lotus Tower as nodes in a broader strategy to encircle it through the "String of Pearls." In response, India has actively pursued its own regional partnerships, including infrastructure projects in Sri Lanka, to counterbalance China's influence.[22]

On the other hand, China frames its involvement as purely economic, emphasizing the development potential of the BRI.[23] Influential Chinese actors, including state-owned enterprises and high-level diplomats, have been heavily involved in shaping the scope of these projects, ensuring that Chinese firms receive lucrative contracts.[24] Chinese loans to Sri Lanka have been tied to concessional terms with conditions that secure long-term Chinese involvement, such as operational control over strategic assets like MRIA. Interviews suggest that China has used diplomacy and economic incentives to solidify Sri Lanka's participation in the BRI, with visits by Chinese officials closely aligned with project launches and loan agreements.

Influential Actors from China and India

China's influence in Sri Lanka has been driven by economic incentives, primarily through concessionary loans targeting large-scale infrastructure projects. The Export-Import Bank of China played a pivotal role in financing key ventures, such as the MRIA and the Colombo Lotus Tower. Beyond financing, Chinese companies, most notably the China Harbour Engineering Company and China Merchants Port Holdings, were responsible for project execution, ensuring Chinese control over operations and standards. China framed these investments as win-win opportunities, promising economic development and enhanced connectivity for Sri Lanka. However, the non-transparent terms of some loans and projects, combined with the heavy reliance on Chinese contractors, have raised concerns about debt dependency and loss of sovereignty.

India, viewing China's growing presence as a challenge to its strategic influence in the Indian Ocean, responded with its own set of development projects. These included investments in railways, energy, and housing reconstruction, particularly in the northern and eastern provinces with significant Tamil populations, reflecting India's soft power strategy. India also promoted educational and cultural exchanges, highlighting shared historical ties and civilizational links to position itself as a more familiar and trustworthy partner. Furthermore, India provided humanitarian aid and capacity-building support for Sri Lankan institutions, distinguishing itself from China's focus on large infrastructure. India's engagement aimed to counterbalance Chinese influence by addressing local needs and reinforcing people-to-people ties, framing itself as Sri Lanka's natural regional ally.

Tactics Employed by Rival Powers to Apply Pressure on Sri Lanka

Both China and India have employed various pressure tactics to influence Sri Lanka's political and economic decisions. Chinese investments in Sri Lanka often come with financial incentives, such as low-interest loans and technical assistance, but these projects also carry certain risks, including concerns over debt dependency. A prominent example is the 2017 leasing of the Hambantota Port to China Merchants Port Holdings, a Chinese state-owned company, for 99 years. This followed the port's financial underperformance and Sri Lanka's broader struggle to service its external debt. Some analysts and Western officials allege that China used debt restructuring as leverage to secure this strategic asset, an argument often cited in discussions of "debt-trap diplomacy." However, this claim is contested. Scholars like Deborah Brautigam argue that the decision to lease the port was initiated by Sri Lanka itself and not imposed by China, pointing out that Sri Lanka's debt to China constituted only a portion of its total external debt. Nevertheless, the case is widely interpreted as an instance where China's financial influence translated into a strategic foothold in the Indian Ocean, raising concerns in India and among Western powers.

On the other hand, India has consistently applied diplomatic pressure to dissuade Sri Lanka from aligning too closely with Beijing, especially in areas with strategic sensitivity. Sri Lankan officials have reported instances where Indian diplomats intervened directly to discourage the government from approving Chinese-backed initiatives. A notable case occurred in 2021 when India strongly opposed awarding renewable energy projects in the Northern Province (specifically in the Delft, Nainativu, and Analaitivu islands) to a Chinese firm. Following India's protests and concerns over potential security threats near its maritime border, Sri Lanka cancelled the Chinese contract and later signed a memorandum of understanding with India for the same projects (The Hindu, 2021).

India has also raised objections to Chinese involvement in the Eastern Province's infrastructure, particularly in the Trincomalee region, which New Delhi considers strategically important due to its proximity to Indian shipping lanes. Moreover, during Sri Lanka's 2022 economic crisis, Indian officials reportedly linked further financial aid to Colombo's willingness to limit Chinese influence, including delaying certain port and logistics deals with Beijing (Reuters, 2022). At that time, India extended a credit line and fuel assistance package worth more than USD 4 billion. However, Sri Lankan sources claimed the support was also a means of ensuring geopolitical alignment with Indian interests.

These episodes highlight how India uses both carrots (financial support) and sticks (diplomatic pushback) to shape Sri Lanka's external alignments, particularly when it perceives its regional influence to be at stake.

Sri Lanka's Response to External Pressure: Balancing, Hedging, and Strategic Pragmatism

In response to the competing pressures from China and India, Sri Lankan leaders have adopted a pragmatic and multifaceted balancing strategy. Recognizing its geopolitical vulnerabilities, Sri Lanka has sought to maintain favorable relations with both regional powers while minimizing dependency risks. This has involved strategically diversifying economic partnerships by engaging countries such as Japan and the United States and pursuing a non-aligned foreign policy posture emphasizing development cooperation without exclusive allegiance.

A key feature of Sri Lanka's approach has been hedging, leveraging the interests of rival powers to extract economic and political benefits. Under the Rajapaksa administration, Sri Lanka actively pursued Chinese infrastructure financing, including major projects like the Hambantota Port. However, subsequent governments sought to recalibrate this alignment by endorsing Indian- backed initiatives, particularly community-level development projects and energy cooperation in the Northern Province.

This balancing act reflects an awareness of the strategic costs associated with overreliance on any single partner. For example, the 99-year lease of Hambantota Port to a Chinese firm was seen by some domestic actors as a necessary step to address mounting debt pressures, while others criticized it as compromising sovereignty. These internal divisions underscore broader tensions within Sri Lankan political discourse, where factions alternately frame Chinese investment as a pathway to development or a source of strategic vulnerability.

To manage its external debt burden, the government has also reviewed loan agreements and emphasized cultural diplomacy to shape a narrative of neutrality. By cultivating a position as a neutral and strategic actor in the Indian Ocean, Sri Lanka has been able to negotiate more favorable terms with both China and India. This calibrated diplomacy has allowed the country to extract targeted benefits, even amid rising regional competition and scrutiny over foreign influence.

Conclusion

The Mattala Rajapaksa International Airport, initially envisioned as a regional hub to complement the Hambantota Port, remains one of the most controversial Chinese-backed projects in Sri Lanka. Despite significant investment, the airport has been largely underutilized and continues to operate far below capacity, leading to criticism that it symbolizes wasteful spending and poor planning. Similarly, the Colombo Lotus Tower, intended to showcase Sri Lanka's economic ambitions, has struggled to generate significant economic returns. These projects have drawn widespread criticism as "white elephant" investments that have burdened Sri Lanka with debt without delivering substantial economic benefits.

These projects offer valuable insights into small states' challenges in pursuing development amid regional rivalries. They reflect Sri Lanka's struggles to balance short-term development needs with long-term strategic interests, highlighting the complex interplay between national priorities and external influences. Moreover, the outcomes of these projects underscore the limited capacity of small states to influence regional dynamics, as they are often constrained by both internal governance challenges and external geopolitical pressures.

Case Study 2

The East Container Terminal

In 2005, the Sri Lanka Ports Authority (SLPA) introduced the "Colombo Port Expansion Project" to address the rising demand for cargo traffic. The project involved constructing a 5.14 km main breakwater, a 1.65 km secondary breakwater, and essential infrastructure. The proposed harbor would span 600 hectares and reach a depth of 18 meters, incorporating three terminals: the South Container Terminal, East Container Terminal, and West Container Terminal.[25] The ECT includes a 1,200-metre quay wall and an 18-metre-deep berth, enabling it to accommodate three mega ships simultaneously.[26] Additionally, the terminal features a 57-hectare container yard constructed from reclaimed sea sand. The Colombo Port Expansion Project is designed to handle an annual throughput of approximately 7.2 million twenty-foot equivalent units.[27] Its projected revenue contribution is significant, with estimates suggesting it could generate more than USD 200 million annually in direct revenue, while indirectly contributing to wider economic growth through enhanced trade, logistics, and employment opportunities.[28]

India, seeking to counter China's growing influence in Sri Lanka, has expressed strategic interest in the Colombo port. Securing control or participation in the ECT's development would give India a crucial strategic presence, allowing it to monitor key shipping lanes and safeguard its regional interests. This move is viewed as essential for India in managing China's expanding role in Sri Lanka's maritime infrastructure, which India perceives as a potential security threat.

Rival Power Interests in the Project

The Colombo Port Expansion Project has become a focal point in the strategic competition between China and India. For China, the expansion of the Colombo Port represents an opportunity to enhance its Maritime Silk Road initiative and secure a foothold in a region crucial for trade and energy supply routes. Chinese investments in Sri Lankan infrastructure, including the Hambantota Port, have raised concerns in New Delhi about China's intentions and ability to exert influence over Sri Lanka's strategic assets. As part of the Colombo Port Expansion, China Merchants Port Holdings Company invested approximately USD 500 million to develop the Colombo International Container Terminal, a joint venture with the SLPA, which holds a 15 percent stake.[29]

Conversely, India views the Colombo Port Expansion Project as a vital project that could either bolster or undermine its regional security interests. India's strategic interest in the ECT is particularly pronounced; securing control or active participation in the terminal's development would enable India to monitor critical shipping lanes and safeguard its maritime interests against the backdrop of China's expanding role in Sri Lanka's infrastructure. In 2021, Sri Lanka approved a tripartite deal involving India's Adani Group, Japan, and SLPA to develop the East Container Terminal, with Adani committing USD

700 million in investment.[30] However, this deal was later modified, and India was offered involvement in the West Container Terminal instead, also with an expected investment of USD 700–750 million. Meanwhile, the Sri Lankan government has contributed significantly to breakwater construction and marine infrastructure, with SLPA spending an estimated USD 800 million on the broader port expansion.[31] The total projected cost of the entire Colombo Port Expansion Project, including marine and landside development, has been estimated at over USD 1.5 billion.

As one Indian naval officer articulated in an interview, "Control over key maritime assets is essential to maintain regional stability and counteract external influences that could jeopardize our national security."

Influence and Strategic Tactics of China and India in the Colombo Port Expansion Project

Both China and India have been deeply engaged in Sri Lanka's infrastructure development, asserting influence through a combination of economic investments, diplomatic engagement, and strategic pressure, particularly regarding the Colombo Port Expansion Project.

China has primarily exerted its influence through large-scale investments and construction expertise. The China Harbour Engineering Company served as the main contractor for the Colombo International Container Terminal's marine works, valued at approximately USD 500 million, and has also invested USD 1.4 billion in the adjacent Port City Colombo.[32] As one expert noted in an interview, "China has provided not only funding but also technology and expertise that are crucial for such large-scale projects." Chinese officials often frame this cooperation as a "win-win" scenario, emphasizing economic development, though critics argue that these investments also serve geopolitical ambitions.[33]

However, China's model of infrastructure financing, often labeled "debt-trap diplomacy" by Western analysts, has drawn international scrutiny. The 99-year lease of Hambantota Port to a Chinese firm after Sri Lanka's loan default is often cited as an example, raising alarm in New Delhi over China's expanding footprint in the Indian Ocean.

India has intensified its development diplomacy in response, particularly in Northern and Eastern Sri Lanka. It has pledged over USD 350 million for housing reconstruction and more than USD 1 billion in concessional credit for railway and transport infrastructure. In total, India has committed over USD 3.5 billion in development assistance since 2005, aimed at both economic development and strategic balancing (MEA India, 2022; Exim Bank of India; High Commission of India in Colombo). An Indian diplomat emphasized, "Our aim is to reinforce our historical ties with Sri Lanka, ensuring that we remain a key partner in their development journey."

Alongside economic aid, India also leverages its cultural and historical ties, emphasizing shared civilizational values, regional security cooperation, and mutual interests. As a Sri Lankan Ministry of Foreign Affairs official explained, "India's long-standing partnership is not just about economics; it's also about our shared values and mutual security interests."

Together, these developments highlight how Sri Lanka's strategic location has made it a site of intensifying regional competition, with both Beijing and New Delhi seeking influence through a complex interplay of infrastructure, diplomacy, and geopolitical strategy.

Sri Lanka's Strategic Response to External Pressure

Sri Lanka's response to the competing pressures from China and India has been defined by a strategic hedging approach. Aiming to avoid over-dependence on any single power, successive governments have sought to balance relations by engaging both countries selectively to maximize economic benefits while safeguarding national sovereignty. This has included diversifying control over key infrastructure, such as allowing China Merchants Port Holdings to operate the Colombo International Container Terminal, while involving India and Japan in the proposed development of the ECT to provide India a strategic foothold in the port.

This balancing act has sparked mixed reactions within Sri Lanka. While some political factions and business groups welcome the investments and economic opportunities generated by Chinese engagement, others, particularly civil society organizations, have raised concerns about sovereignty, external influence, and environmental degradation. For instance, proposed expansions of the ECT have been met with local resistance due to fears of ecological harm and a lack of transparency in project governance.

By adopting this dual-engagement model, Sri Lanka continues to attract foreign investment, preserve strategic autonomy, and manage its delicate geopolitical position in the Indian Ocean. This hedging strategy not only helps maintain cordial ties with both China and India but also reinforces Sri Lanka's identity as a non-aligned actor pursuing pragmatic development partnerships.

Conclusion

The ECT project has yielded several outcomes for Sri Lanka, both positive and negative. Economically, the project is expected to significantly enhance the country's port capacity, thereby boosting trade and attracting foreign investments. The increased cargo handling capabilities will position Sri Lanka as a critical maritime hub in the Indian Ocean.

However, the project has also sparked domestic controversy and raised concerns. Labor unions and port workers have protested foreign involvement, particularly India's role, arguing that it compromises national sovereignty and undermines local control over strategic assets. Additionally, civil society groups and environmental advocates have raised alarms about potential ecological damage stemming from construction activities and increased port traffic, especially due to limited environmental oversight. Politically, the project has contributed to divisions within government coalitions, with some factions opposing foreign partnerships in port infrastructure as a matter of principle. These tensions underscore the complex trade-offs in balancing economic development with sovereignty, environmental protection, and public accountability.

Case Study 3

The Trincomalee Oil Farm Lease

India’s renewed initiative to develop the Trincomalee Oil Tank Farm marks a significant step toward integrating Sri Lanka into its national energy framework.[34] Constructed by the British in the 1930s, the oil farm has a storage capacity of 1.2 million tons and originally comprised 100 oil tanks, 99 of which remain largely intact with minimal functional damage.[35] The farm remained unused after the British left the island, and decades of neglect and political complications that followed have left only a fraction of the tanks operational. However, the farm gained the attention of several external actors. Since the 1987 Indo-Lanka Accord, India has expressed ongoing interest in developing the facility, and in 2004, the Indian Oil Corporation (IOC) acquired several of the tanks. Recently, India expanded its control over the facility through a bilateral agreement granting the IOC a 50-year site lease. Given the strategic value of Trincomalee Harbor and its potential to dominate the northeast Indian Ocean, this oil farm serves as a major interest of India in securing its presence in the South Asian region as well as in ensuring India's domination in the hydrocarbon sector.

Rival Power Interests in the Project

The power rivalry between India and China in Sri Lanka has been most visible in the infrastructure development sector; however, recently, this competition has intensified within the energy sector. India has long been cautious about allowing a Chinese presence in its immediate neighborhood. Given the strategic significance of the oil farm and its proximity to Trincomalee Harbor, the remnants of this British-era facility have consistently attracted interest, particularly from India. As India established a strategic presence in the country's energy sector and the development of projects in northeast Sri Lanka, Chinese interests have focused on southern Sri Lanka, particularly through the maintenance of a bunkering facility and tank farm at Hambantota.

Given that the New Delhi-run Indian Oil Corporation is Sri Lanka's second-largest fuel supplier after the Sri Lankan government-owned Ceylon Petroleum Corporation, China, through its Sinopec Group, has endeavored to increase its energy-sector presence in the country.

The Trincomalee Oil Tank Farm: Strategic Influence and Constraints

In January 2022, Sri Lanka and India formalized a joint development agreement for the long-neglected Trincomalee Oil Tank Farm, a strategically located facility comprising 99 storage tanks built by the British during World War II. The agreement led to the creation of a joint venture, Trinco Petroleum Terminal Ltd, in which the Ceylon Petroleum Corporation holds a 51 percent controlling stake, while the Lanka Indian Oil Corporation

(LIOC), a subsidiary of India's state-owned IOC, holds 49 percent. Although the Ceylon Petroleum Corporation retains majority ownership, the agreement gives LIOC substantial operational influence, particularly through clauses requiring mutual consent for key decisions regarding usage, development, or third-party involvement.

This arrangement means Sri Lanka cannot unilaterally lease or develop the unused tanks without Indian approval, effectively restricting its ability to diversify energy partnerships or attract investment from other interested actors such as China, which has expressed growing interest in the island's energy and logistics sectors. Indian officials have emphasized the agreement as a vital move to cement India's strategic footprint in Sri Lanka's northeastern region, which sits close to India's southern coast and near vital shipping routes in the Bay of Bengal.

The project has been valued at approximately USD 45 million in the initial phase, focused on refurbishing 61 tanks in the Upper Tank Farm, with infrastructure upgrades funded by both parties. During the island's severe economic crisis, India has extended additional grants and credit lines for fuel and energy sector stabilization in Sri Lanka, amounting to over USD 500 million in 2022 alone.[36]

While Chinese influence on this particular project remains minimal, China has played a broader role in Sri Lanka's energy sector, notably by funding power generation infrastructure (e.g., the Norochcholai coal power plant) and proposing renewable energy projects in the Northern Province. One such Chinese proposal in 2021 was cancelled after Indian objections, and India was later awarded the project.

Although the 2022 Trinco agreement builds on the provisions of the 1987 Indo-Lanka Accord, which originally proposed joint development of the oil tanks, the recent deal has renewed domestic debates over sovereignty and strategic autonomy. Critics argue that while the joint venture secures Indian investment and long-overdue modernization of the tank farm, it may also limit Sri Lanka's future energy policy flexibility and reinforce external dependencies.

Sri Lanka has adopted a strategic balancing approach in managing the interests of both India and China within its energy sector. While India has sustained long-standing influence, particularly in Trincomalee, Sri Lanka has concurrently supported Chinese engagement in various developmental projects in the energy sector. Notable examples include China's involvement in maintaining a bunkering facility and tank farm in Hambantota and developing the Norochcholai Coal Power Plant.

Conclusion

In the short term, the Trincomalee oil tank project positions Sri Lanka in a dependent relationship with India, requiring Indian consent for key decisions regarding the oil tank facility. This dependence may limit Sri Lanka's ability to independently manage its energy resources or secure favorable terms in future agreements, especially given its ongoing economic difficulties. Additionally, substantial investment is needed to refurbish and develop the underutilized oil tanks. While LIOC has invested approximately USD 40 million over nearly two decades, Sri Lanka's economic crisis complicates its ability to contribute financially to further development. This financial strain, compounded by the lack of immediate returns from the tank farm, poses a short-term economic burden to the country.

Long-term outcomes present further challenges and opportunities. Sri Lanka's economic dependency on Indian investment and expertise could restrict its ability to develop energy resources autonomously, potentially limiting future economic growth and diminishing energy security. Strategically, India's control over Trincomalee risks converting the tank farm into a reserve that primarily serves Indian interests, which could weaken Sri Lanka's bargaining power in regional energy markets. This dynamic raises sovereignty concerns, as India's strategic interests could influence Sri Lanka's policy options, affecting regional security and autonomy. Moreover, Sri Lanka's failure to capitalize on Trincomalee as a petroleum hub represents missed economic opportunities. Public opposition and political sensitivities regarding foreign control over national assets may further constrain the government's capacity to navigate these challenges, highlighting a complex balance between regional alliances and domestic priorities.

The tank farm also holds the potential to bolster Sri Lanka's energy security, particularly with the construction of bidirectional underwater cables linking India and Sri Lanka. Such an initiative could establish the tank farm as a strategic hydrocarbon reserve for both India and the broader South Asian region. This increased energy interdependence between the two countries could position Sri Lanka as a key producer and exporter of renewable energy.

This paper has examined Sri Lanka's complex navigation of competing influences from China and India, focusing on the country's strategic responses to external pressures through infrastructure investments, diplomatic agreements, and economic partnerships. The findings illustrate how Sri Lanka, a small state in a strategically vital region, employs nuanced hedging strategies to manage great power competition while pursuing national development goals.

A central insight is the pivotal role of Sri Lanka's leadership—both political figures and broader elites—in orchestrating this balancing act. Rather than aligning exclusively with either China or India, Sri Lanka has sought to diversify its partnerships and maintain a position of non-alignment. This pragmatic approach enables the country to leverage rival powers' investments and financial assistance to stimulate economic growth, particularly in key sectors such as ports, energy, and transportation. At the same time, this strategy reflects an acute awareness of the risks posed by overreliance on a single actor, including threats to sovereignty and domestic political stability.

However, the study also highlights the inherent tensions and contradictions small states face in such a position. Sri Lanka's efforts to benefit from multiple external actors have sparked internal debates among political factions, civil society, and interest groups regarding the long-term consequences of foreign investments. Concerns over environmental degradation, sovereignty, and strategic autonomy are frequently voiced, illustrating that balancing great power interests is not merely a geopolitical challenge but also a domestic political one.

From a broader theoretical perspective, Sri Lanka's case offers important lessons on small state behavior in international relations. It exemplifies how small states exercise agency by actively engaging and managing great powers, rather than passively succumbing to external pressures. Sri Lanka's hedging demonstrates a sophisticated understanding of its geopolitical environment and the use of economic diversification and diplomatic balancing as tools to maximize national benefits. Nevertheless, it also reveals the limits of such strategies, as small states must continuously negotiate internal consensus and address vulnerabilities arising from global power rivalries.

In sum, Sri Lanka's experience underscores the complexity of small state diplomacy in the contemporary international system, where economic imperatives intersect with security concerns and domestic politics. For policymakers and scholars alike, the case of Sri Lanka illustrates that small states are neither helpless nor uniformly aligned; instead, they navigate a dynamic and contested landscape with calculated pragmatism, adaptability, and cautious engagement.

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The Regional Centre for Strategic Studies

The Regional Centre for Strategic Studies was established in 1992 by Professor Shelton U. Kodikara, Sri Lanka's first International Relations professor, in a bid to further South Asian integration, as the region was making gradual steps in this direction. It is an independent organization which encourages research, dialogue and deliberation on a broad range of issues in the sphere of international relations. Through its wide network, the RCSS enables scholars to address, individually and collectively, problems and issues of topical interest for all South Asian countries.

In recent years, much emphasis has been placed on emerging voices, and the building of awareness to create a better-informed society across South Asia. Such efforts are geared towards equipping young people to grasp global issues, be prepared for the path ahead, and to contribute effectively to the creation of a safer and more secure South Asia.

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