

AGENCY AND CONSTRAINTS: SMALL STATES IN THE NEW WORLD ORDER

Perspectives From Nepal



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ISAS-NEF Roundtable

Agency and Constraints: Small States in the New World Order

Perspectives from Nepal

August 2026

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Executive Summary

The discussion brought together participants from the academia, think tanks, diplomacy and the private sector to reflect on Nepal's strategic position within a changing international environment.

This Special Report examines how Nepal navigates the opportunities and constraints faced by small states in an evolving global order. It draws on insights from a closed-door expert roundtable convened on 3 June 2025 in Kathmandu by the Institute of South Asian Studies (ISAS) at the National University of Singapore, Nepal Economic Forum (NEF) and its platform, the Himalayan Future Forum (HFF). The discussion brought together participants from the academia, think tanks, diplomacy and the private sector to reflect on Nepal's strategic position within a changing international environment.

The report highlights how Nepal's position between India and China shapes its foreign policy choices, requiring careful diplomatic balancing while preserving strategic autonomy. Although non-alignment historically provided a framework for maintaining autonomy, growing geopolitical competition and weakening multilateral institutions now require more flexible approaches to diplomacy and partnership-building.

The discussion also underscored Nepal's potential sources of leverage, including diaspora networks, youthful population and its strategic position in the Himalayan region. Strengthening institutional capacity, diversifying partnerships and adopting a more proactive diplomatic posture could enable Nepal to exercise greater agency despite structural constraints.

Introduction

The global system is undergoing significant fragmentation and re-ordering. The role of multilateralism, economic interdependence and rule-based governance has recently come under visible strain. The intensifying United States (US)-China competition, rising conflicts in Europe (Russia-Ukraine) and the Middle-East (Iran-Israel-US) and the emergence of the middle powers is reshaping the international order in ways that creates both uncertainty and opportunity for smaller states.

This report, a culmination of a closed-door expert discussion convened on 3 June 2025 in Kathmandu by ISAS, NEF and HFF, reflected on the strategic choices that the evolving international order provides for small states, particularly Nepal. The insights from this discussion are the premise for this report.

The pressures of the international system are immediate and structural and have resulted in systemic and strategic debates in smaller geographically-enclosed states such as Nepal. Although the definition of a ‘small state’ itself requires caution as size is relative. Nepal’s vulnerabilities do not stem simply from its territorial scale or population but from structural exposure to external shocks, economic dependence, institutional limitations and the realities of geography. Thus, the strategic question is no longer simply how to preserve autonomy but how to exercise agency within a more volatile and transactional international order.

Nepal’s location between India and China creates both strategic sensitivity and strategic possibility. As several examples suggest, being positioned between larger powers can create constraints but it can also create diplomatic space when managed effectively.

The international environment is marked by global churn. Some interpret this as a transition toward multipolarity. Others see a more unstable world disorder rather than a coherent new order. The weakening of traditional multilateral frameworks, the return of strategic competition, the growing politicisation of trade, finance, energy and technology and the emergence of new forms of rule-making all point to a world in transition. Smaller states must now navigate a system where predictability is declining, and strategic hedging is becoming more complex.

Nepal’s vulnerabilities do not stem simply from its territorial scale or population but from structural exposure to external shocks, economic dependence, institutional limitations and the realities of geography.

For Nepal, this moment also forces a deeper internal reckoning. External vulnerability is only one part of the equation. Institutional capacity, negotiation capability, governance effectiveness, economic competitiveness and strategic clarity increasingly determine how much room a smaller state has to manoeuvre. The question is not simply what the world is becoming but whether Nepal is positioned to respond to it with coherence and confidence.

The Global Order in Flux: Implications for Small States

The international environment is increasingly defined by fragmentation, competition and uncertainty. Rather than a stable ‘new world order’, the current period resembles an unsettled transition in which established structures are weakening while alternative arrangements remain incomplete. For smaller states, this creates a far more difficult strategic environment.

Multilateral institutions no longer offer the same degree of protection, predictability or legitimacy that they once did. Institutions that historically provided smaller states with diplomatic space are under pressure. For instance, the United Nations (UN) faces paralysis on major conflicts involving great powers; the World Trade Organisation’s (WTO) dispute mechanisms have weakened and even poignant issues, including climate negotiations, are progressing at a snail’s pace due to increasing nationalist resistance. Thus, the broader rules-based order appears less reliable than it was in previous decades.

Institutions that historically provided smaller states with diplomatic space are under pressure.

This matters deeply for countries like Nepal. Smaller states have traditionally relied on multilateral frameworks as means to ensure their security and development and their contribution to global governance.¹ When bilateral asymmetries are significant, multilateral institutions provide alternative platforms for voice, legitimacy and protection. The erosion of these institutions reduces strategic options.

Simultaneously, the nature of rule-making is dramatically changing. Rules are no longer shaped only through formal state-led multilateral processes. Increasingly, power is exercised through informal coalitions, minilateral groupings, with private actors becoming key players. This has resulted in creating piece-meal national standards that complicate global governance architecture.² Technology governance is a clear example. Major decisions affecting global systems are increasingly shaped by powerful private actors rather than traditional international institutions. Questions of digital governance, supply chains, critical minerals and infrastructure financing increasingly fall into contested spaces where formal rules remain unsettled.

1 Adam Lupel, Kaewkamol Pitakdumrongkit and Joel Ng, *Small States and the Multilateral System: Transforming Global Governance for a Better Future*, International Peace Institute, 2024.

2 Ibid.

This creates a more complex environment for smaller states. If the rules themselves are becoming unstable, strategic planning becomes harder. The question is no longer simply whether to follow existing rules but whose rules are emerging, where they are being made and how smaller states engage with them.

Strategic competition among major powers further complicates this landscape. The Russia-Ukraine war, the US-China rivalry, tensions in the Indo-Pacific, conflict in the Middle East and growing uncertainty across multiple theatres suggest that the international system is becoming more confrontational. Some view this as a shift toward multipolarity.³ Others see elements of bipolar competition or even a return to spheres-of-influence politics.⁴

Economic fragmentation reinforces these pressures. Trade, energy, finance and technology are increasingly weaponised. Deglobalisation is visible in some capital flows even if labour mobility remains resilient.

For smaller states, the distinction matters. Multipolarity can create room for manoeuvre if multiple partnerships remain available. Spheres-of-influence politics sharply reduce that space.⁵ Countries located near larger strategic powers face more direct pressure to align, accommodate or hedge carefully. Economic fragmentation reinforces these pressures. Trade, energy, finance and technology are increasingly weaponised. Deglobalisation is visible in some capital flows even if labour mobility remains resilient. Nationalist economic strategies are replacing earlier assumptions about open global integration. ‘America First’, ‘Make India Great Again’ and similar approaches reflect a wider shift toward national prioritisation over collective governance.

This shift weakens predictability for smaller economies. Aid flows are becoming less certain. Strategic investment is increasingly politicised. Development partnerships are shaped more directly by geopolitical calculations. Economic vulnerability is, therefore, becoming inseparable from strategic vulnerability.

3 Gemma Deng Cheng'er Deng and Jim O'Neill, "The West Is Not Ready for a Multipolar World", Project Syndicate, 31 December 2025. <https://www.project-syndicate.org/commentary/west-not-ready-multipolar-world-of-emerging-powers-china-india-brics-by-gemma-chenger-deng-and-jim-o-neill-2025-12>.

4 Jennifer Lind, "Back to bipolarity: How China's rise transformed the balance of power", *International Security* 49, no. 2 (2024): 7-55.

5 Shreeram Thakur, "From Non-Alignment to Strategic Hedging? Explaining Nepal's Foreign Policy Behaviour in the Emerging Multipolar Order", *International Journal of Research Publication and Reviews*, Vol (7), Issue (6), 2026, pp. 95-105, <chrome-extension://efaidnbmnnnnbpccajpcglclefindmkaj/https://ijrpr.com/uploads/V7ISSUE6/IJRPR66512.pdf/>.

However, disorder can also create opportunities. Smaller states can still build issue-based coalitions. Climate justice, migration, peacekeeping, ecological diplomacy and regional functional cooperation remain areas where smaller states can exercise influence. Small island states have already demonstrated how normative positioning can shape international agendas. The question is whether states like Nepal can translate vulnerability into strategic agency rather than simply reacting to external pressure.

Nepal's Strategic Posture: Continuity, Caution and Constraints

Nepal's foreign policy continues to be shaped by geography, asymmetry and the constant need to preserve strategic space between larger powers. Nepal has historically navigated its position between India and China through a combination of balancing, caution, non-alignment and selective engagement. What changes today is the scale and intensity of geopolitical competition surrounding the region.

The idea of balancing and non-alignment remains central to Nepal's strategic posture, though the term itself is often used loosely.⁶ In practice, balancing refers to the ability to exercise an independent foreign policy without becoming excessively guided by the strategic preferences of any one external actor. For Nepal, this requires maintaining workable relationships with multiple powers while avoiding direct alignment within larger geopolitical rivalries.⁷

Agreements involving infrastructure, energy, connectivity, development financing or technology are no longer viewed as purely economic arrangements.

This approach has deep historical roots. Nepal has historically relied on different instruments to preserve sovereignty and manoeuvrability that include appeasement, non-alignment, diplomatic hedging and layered engagement with multiple actors simultaneously. Earlier phases of global politics allowed smaller states greater room to remain outside major power polarisation. However, the current environment is less forgiving. Now, bilateral engagements increasingly carry wider geopolitical implications, and even seemingly technical agreements are now interpreted through strategic lenses. In turn, this creates a narrower and more complicated diplomatic space. Agreements involving infrastructure, energy, connectivity, development financing or technology are no longer viewed as purely economic arrangements. External actors increasingly interpret them as indicators of strategic orientation. Nepal, therefore, operates in a context where almost every major external engagement risks geopolitical signalling.

⁶ Amrit Poudel, "Nepal in a multipolar world", *The Kathmandu Post*, 20 April 2023, <https://kathmandupost.com/columns/2023/04/20/rise-of-multipolarity-and-nepal>; and Shreeram Thakur, "From Non-Alignment to Strategic Hedging? Explaining Nepal's Foreign Policy Behaviour in the Emerging Multipolar Order", op. cit.

⁷ Pranab Raj Koirala, "Nepal's Quest for balance in a Multipolar Global Landscape", *MyRepublica*, 15 August 2023, <https://myrepublica.nagariknetwork.com/news/nepal-s-quest-for-balance-in-a-multipolar-global-landscape/>.

The negotiations surrounding the Belt and Road Initiative (BRI) implementation framework illustrate these pressures clearly. Concerns emerge not only around infrastructure cooperation itself but around the broader international implications of specific language, financing modalities, implementation structures and strategic interpretation.⁸ Questions of whether projects are grant-based, loan-based or categorised as 'aid financing' become politically sensitive because terminology itself carries geopolitical meaning.

This reflects a broader reality confronting smaller states. Negotiation is no longer limited to securing economic benefit. It also involves managing interpretation, strategic perception, coalition politics and external sensitivities simultaneously. For Nepal, diplomatic negotiation increasingly requires technical capacity, institutional preparation and long-term strategic coherence. Nepal's strategic posture is also constrained by domestic fragmentation. Internal balancing remains weak. Political instability, changing coalitions, institutional inconsistency and fragmented policy implementation reduce the state's ability to negotiate from a position of confidence.⁹ Foreign policy often lacks continuity, and strategic priorities shift with political transitions. This weakens implementation capacity even when agreements are successfully negotiated.

For Nepal, diplomatic negotiation increasingly requires technical capacity, institutional preparation and long-term strategic coherence.

Governance, therefore, becomes a geopolitical issue. Countries that successfully navigate strategic competition tend to possess stronger institutions, clearer negotiation structures and long-term strategic planning mechanisms. Comparisons with countries such as Singapore, Switzerland, Rwanda and Bhutan repeatedly point toward institutional discipline rather than geography alone. Smaller states can create strategic space when governance structures function coherently and national priorities remain relatively stable.

Regional platforms have not substantially reduced Nepal's vulnerabilities. The South Asian Association for Regional Cooperation (SAARC) remains largely paralysed while other regional frameworks have produced uneven outcomes. The decline of regional cooperation in South Asia limits opportunities for smaller states to aggregate bargaining power

⁸ Amrit Poudel, "Nepal in a multipolar world", op. cit.

⁹ Note for the Reader: These discussions were held prior to the overthrow of the government and fresh elections held in Nepal in 2026.

Nepal does not fundamentally alter the balance of power between India and China but its position matters precisely because of geography.

collectively. As larger regional rivalries intensify, smaller countries are often left managing bilateral asymmetries individually.

At the same time, Nepal's vulnerabilities also create forms of strategic relevance. Nepal does not fundamentally alter the balance of power between India and China but its position matters precisely because of geography. While the country used to be considered a buffer, it can function as a potential bridge. Its location in the Himalayan region gives it importance in questions of connectivity, climate, water resources, energy, migration and regional stability. This creates opportunities that Nepal has not always fully leveraged. Climate diplomacy, hydropower diplomacy, diaspora engagement, labour mobility, mountain ecology and green finance increasingly emerge as areas where Nepal can exercise greater visibility and leadership. Smaller states cannot compete through scale but they can position themselves around specific issues where moral authority, strategic relevance or functional expertise create influence.

Yet this requires strategic clarity. Nepal's challenge is not simply external pressure. It is the absence of sufficient domestic preparedness to convert geopolitical attention into long-term national advantage. The issue is not whether larger powers will compete in Nepal's neighbourhood. That competition already exists. The more important question is whether Nepal possesses the institutional capacity, negotiation ability and policy continuity necessary to engage external actors on terms that serve long-term national priorities rather than short-term political calculations.

Exercising Agency: Framing of Issues and Sources of Strategic Leverage

Nepal is often characterised as a small state within the international system. However, in demographic terms, the country is not necessarily small when compared to states such as Norway or Sweden. Rather, Nepal's 'small state' status is largely relational, shaped by its position within South Asia and its location between two major powers, India and China. This geographic reality places Nepal in a structurally sensitive position, requiring it to constantly navigate the competing interests of its neighbours while maintaining autonomy in foreign policy decision-making.¹⁰

Nepal's strategic environment is further shaped by its location within the Hindu Kush Himalayan region which exposes the country to climate vulnerabilities, environmental pressures and natural disasters, all of which require stronger institutional capacity and coordinated policy responses.¹¹ Strengthening national agencies, therefore, requires scaling up competitive advantages, diversifying external partnerships and strengthening the capacity of state institutions to respond to external shocks.

Historically, Nepal has adopted different foreign policy approaches to preserve its sovereignty as a weaker power surrounded by larger neighbours. Earlier strategies included elements of accommodation and appeasement, particularly during the period of Prime Minister Jung Bahadur Rana.¹² Over time, this evolved into a more deliberate strategy of balancing relations between India and China while avoiding excessive alignment with either side. However, bilateral relations rarely remain purely bilateral today as third parties increasingly become involved in regional dynamics.

Following the emergence of the Non-Aligned Movement in the post-colonial period, non-alignment became a central pillar of Nepal's

Strengthening national agencies, therefore, requires scaling up competitive advantages, diversifying external partnerships and strengthening the capacity of state institutions to respond to external shocks.

10 S D Muni, *Foreign Policy of Nepal* (New Delhi: National Publishing House, 1973).

11 International Centre for Integrated Mountain Development (ICIMOD), "The Burning Issue Of Melting Himalayas", *HimalDoc*, 2002, <https://lib.icimod.org/records/5scde-cfm79>.

12 S D Muni, *Foreign Policy of Nepal*, op. cit.

While this policy helped maintain autonomy in the past, the contemporary international environment, characterised by strategic competition, has made strict non-alignment increasingly difficult to sustain.

foreign policy, allowing the country to maintain strategic distance from major power rivalries. While this policy helped maintain autonomy in the past, the contemporary international environment, characterised by strategic competition, has made strict non-alignment increasingly difficult to sustain. Instead, smaller states are increasingly adopting flexible diplomatic approaches that combine bilateral engagement, participation in multilateral institutions and involvement in smaller issue-based coalitions.

At the same time, the weakening of global multilateral institutions has created additional challenges for smaller states. Organisations such as the WTO and the UN Human Rights Council have faced growing political pressure and declining effectiveness, thereby reducing the institutional protections that smaller states have traditionally relied on. As a result, smaller states must increasingly depend on domestic capacity and strategic diplomacy to advance their interests. This reflects a broader shift from rules-based multilateralism towards more fragmented governance structures where influence is often exercised through smaller coalitions, economic networks and issue-based partnerships.

Despite these constraints, examples from other regions illustrate how smaller states can enhance their strategic agency. Countries such as Rwanda, Singapore and Switzerland have successfully navigated structural limitations through strong governance systems, strategic economic planning and active diplomatic engagement. Rwanda, for instance, has leveraged the East African Community to deepen regional economic integration, thereby strengthening its bargaining position within the broader African Union framework. This highlights the role of regional institutions in amplifying the influence of small states.¹³

In contrast, regional organisations in South Asia, including the SAARC and the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation, have delivered more limited strategic benefits for Nepal due to geopolitical rivalries and weak regional integration. This contrast underscores the critical role of governance structures: countries with stronger institutions are generally better equipped to navigate geopolitical pressures and shape effective regional cooperations.

¹³ Dr Francess Virginia Anderson, "The Intersection of Economic Diplomacy and Regional Integration: Contributions of Diplomatic Economic Desks to Africa's Free Trade Area", *Intergovernmental Research and Policy Journal*, Vol. 2025, 18 April 2025, <https://irpj.euclid.int/articles/the-intersection-of-economic-diplomacy-and-regional-integration-contributions-of-diplomatic-economic-desks-to-africas-free-trade-area/>.

Nepal's agency is further constrained by structural economic factors. As a landlocked country with high import dependence and an economy heavily reliant on remittance flows, Nepal remains closely tied to external labour markets and global economic conditions.¹⁴ Moreover, frequent political transitions and personalised political appointments can disrupt long-term strategic planning, complicating efforts to maintain consistent foreign policy priorities.

As Nepal transitions from a low-income to a lower-middle-income country, external economic and political conditions are becoming less favourable. In this context, it becomes increasingly important for Nepal to focus on its competitive advantages and carve out a strategic positioning within global economic networks. While Nepal may not be able to fully pursue multi-alignment, it can pursue multi-engagement, working with multiple partners across sectors but without committing strategically to a single geopolitical bloc.

Early assumptions that small states are 'system-ineffectual states', as described by Robert Keohane, have increasingly been challenged by developments in global governance.¹⁵ For example, small island states and developing countries have successfully influenced climate change negotiations by reframing the issue as an existential political rather than an environmental one, illustrating how strategic framing can enhance the agency of smaller actors.

Nevertheless, Nepal retains several potential sources of strategic leverage. These include a globally dispersed diaspora network, a relatively young population and significant natural and environmental resources. Nepal's potential to position itself as a leading voice on the Himalayan environmental protection and climate change diplomacy offers an opportunity to amplify its international influence despite structural constraints.

While Nepal may not be able to fully pursue multi-alignment, it can pursue multi-engagement, working with multiple partners across sectors but without committing strategically to a single geopolitical bloc.

14 Fabrizio Carmignani, United Nations Office of the High Representative for the Least Developed Countries, Landlocked Developing Countries and Small Island Developing States (UN-OHRLS), *The Development Economics of Landlockedness: Understanding the Development Costs of Being Landlocked* (New York: UN-OHRLS), 2013, https://www.un.org/ohrls/sites/www.un.org.ohrls/files/ldcs_publications/dev-costs-of-landlockedness.pdf.

15 Robert Keohane, "Lilliputians' Dilemmas: Small States in International Politics", International Organization, 22 May 2009, <https://www.cambridge.org/core/journals/international-organization/article/abs/lilliputians-dilemmas-small-states-in-international-politics/5A92C8CA5EEB757F1C2C13D22E95E5E>.

Geoeconomic Realities: Labour, Capital and Structural Dependence

Questions of capital flows, labour mobility, aid dependence, infrastructure financing and economic competitiveness are now deeply entangled with the wider international order.

Nepal's strategic position cannot be understood through geopolitics alone. Geoeconomics increasingly shapes the country's external vulnerabilities, policy choices and long-term development options. Questions of capital flows, labour mobility, aid dependence, infrastructure financing and economic competitiveness are now deeply entangled with the wider international order.

One of the clearest structural realities is Nepal's uneven integration into the global economy. While labour integration remains strong, capital integration (read capital inflows) remains weak.¹⁶ This creates a highly asymmetric economic model in which labour mobility sustains the economy while productive capital flows remain limited.

Remittances continue to anchor Nepal's economic position externally. Labour migration has emerged as one of the most durable features of Nepal's economic structure which has sustained despite repeated concerns of global instability. Even during major disruptions, including COVID-19, remittance inflows remained relatively stable.¹⁷ The likelihood of labour integration continuing to be pivotal is further reinforced by global demographic shifts suggesting that developed economies are likely to require significant labour inflows in the coming decades, suggesting that international labour mobility will remain structurally important. This creates both resilience and dependence. Labour exports provide foreign exchange stability, household income support and macroeconomic breathing space. At the same time, an economy heavily reliant on external labour markets remains vulnerable to policy shifts, migration restrictions, labour market shocks and changing destination-country politics. Nepal participates in globalisation but primarily through labour rather than production or capital integration.

16 Pradeep Panthi, "Reform 2.0: Issues of Nepal's Structural Economic Transformation", Nepal Economic Forum, 7 October 2025, <https://nepaleconomicforum.org/reform-2-0-issues-of-nepals-structural-economic-transformation/>.

17 Sujeev Shakya, "Will Nepali Remittance Bounce Back?", ISAS Insights 626, Institute of South Asian Studies, National University of Singapore, 8 July 2020, <https://www.isas.nus.edu.sg/papers/will-nepali-remittance-bounce-back/>; and Adya Adhikari, "Exporting Talent, Importing Cash: Nepal, Youth Migration and Remittances", South Asia@LSE, London School of Economics and Political Science, 13 May 2024, <https://blogs.lse.ac.uk/southasia/2024/05/13/exporting-talent-importing-cash-nepal-youth-migration-and-remittances/>.

Capital tells a different story. Foreign direct investment remains weak.¹⁸ Nepal has not meaningfully integrated into global production networks or supply chains in ways that attract sustained capital inflows. As a result, development financing continues to depend disproportionately on official development assistance, concessional financing and remittance-driven liquidity rather than investment-led structural transformation.

This model becomes more fragile as the global environment changes. Traditional development partners are shifting priorities. Europe is increasingly preoccupied with strategic security pressures. The US is becoming more inward-looking and transactional. Aid frameworks that previously supported sectors such as health, education and social development are becoming less reliable.

Aid frameworks that previously supported sectors such as health, education and social development are becoming less reliable.

This exposes a deeper structural dependency. Nepal's development model relies not only on remittances but also on external financing ecosystems that may no longer operate as they once did. Aid is increasingly uncertain. Investment remains limited. Domestic productive transformation remains incomplete.

The closure or retrenchment of major aid institutions intensifies this pressure. For a country that has historically externalised significant elements of development delivery through international partners, this creates immediate policy gaps. Infrastructure, social sector delivery and institutional capacity-building can no longer assume predictable external support.

Infrastructure financing introduces another layer of geoeconomic complexity. Financing is no longer purely developmental. It is strategic. Questions surrounding hydropower, transport corridors, connectivity and infrastructure partnerships are increasingly shaped by geopolitical calculation. Projects may be economically viable but still become entangled in wider regional competition.

Hydropower illustrates this clearly. Nepal possesses significant hydropower potential, yet translating this into strategic economic

18 "Nepal: Staff Report for the 2023 Article IV Consultation, First and Second Reviews Under the Extended Credit Facility Arrangement, Requests for Waivers of Nonobservance of Performance Criteria, Extension of the Arrangement and Rephasing of Disbursements-Press Release; Staff Report; and Statement by the Executive Director for Nepal", 4 May 2024, <https://www.elibrary.imf.org/view/journals/002/2023/158/article-A001-en.xml>.

advantage remains difficult. Market access, financing conditions, implementation delays, bureaucratic weakness and geopolitical sensitivities all complicate project execution. Large infrastructure negotiations increasingly require technical sophistication, political coordination and strategic negotiation capacity.

Nepal also faces structural dependence through import reliance. The economy remains externally exposed through trade dependence, limited industrial competitiveness and insufficient domestic product diversification. Economic sovereignty is, therefore, constrained not simply by debt or aid but by structural limitations in competitiveness.

Smaller economies cannot assume open access, neutral capital or predictable commercial logic. Strategic alignment increasingly shapes economic outcomes.

The broader global geoeconomic shift toward deglobalisation, strategic trade and economic nationalism further complicates this environment. Trade, finance and energy are increasingly weaponised. Smaller economies cannot assume open access, neutral capital or predictable commercial logic. Strategic alignment increasingly shapes economic outcomes.

Yet geoeconomic change also creates openings. Nepal's location near two major growth centres, India and China, should theoretically create spillover opportunities. The rise of both neighbours offers potential in trade, connectivity, infrastructure, tourism and investment. The challenge is that proximity alone does not generate benefit. Without stronger institutional capacity and strategic clarity, neighbouring growth does not automatically translate into national advantage.

Diaspora capital, green finance, carbon markets, climate-linked investment and alternative financing mechanisms may offer additional pathways. However, these require institutional innovation, credible governance and long-term strategic planning.

The core challenge remains structural dependence. Nepal is integrated into the global economy but not on terms that generate sustained strategic leverage. Labour sustains resilience but does not substitute for productive transformation. Aid provides support but cannot serve as a permanent development model. Strategic geography creates opportunity but only if matched by domestic economic capability.

The 'Slow State' and the Lack of National Competitiveness Undermining Agency

Nepal's development trajectory continues to be constrained by institutional bottlenecks that slow down planning and implementation. Frequent political transitions, short-lived governments and deeply entrenched patronage networks have created a governance environment in which long-term strategic planning is often deprioritised in favour of short-term political considerations.¹⁹ This has led Nepal to be characterised as a 'slow state' where even well-designed policies and initiatives take years, sometimes decades, to materialise.

Political instability and patronage politics further undermine policy continuity and erode public trust in state institutions. Changes in leadership often bring reshuffles of administrative and technical personnel, disrupting ongoing projects and weakening institutional memory.²⁰ For instance, a project that begins under one administration may face delays or reprioritisation under the next, reducing the efficiency and effectiveness of public investments. Such dynamics also create uncertainty for private sector actors and foreign investors, further constraining economic growth and innovation.

Several major infrastructure and development projects remain delayed, highlighting these systemic inefficiencies. Projects supported by international institutions such as the Asian Development Bank (ADB) and the World Bank have frequently encountered bureaucratic hurdles, complex procurement processes and coordination difficulties across multiple government ministries.²¹ High-profile examples include transport corridors and hydropower projects where delays have led to time and cost overruns and reduced expected returns, undermining Nepal's ability to fully leverage external funding for national development.²²

Changes in leadership often bring reshuffles of administrative and technical personnel, disrupting ongoing projects and weakening institutional memory.

19 Adhikari Krishna and Nabin Paudel, "Lack of Coordination among three tiers of government hampers development pace", *Ratopati*, 13 January 2026, <https://english.ratopati.com/story/44953/interview-lack-of-strong-coordination-among-three-tiers-of-government-hampers-development-pace-npc-vice-chair-shrestha>.

20 Prasain Sangam, "Nepal must prioritise stability and rules-based governance to unlock private investment", *The Kathmandu Post*, 14 March 2026, <https://kathmandupost.com/money/2025/11/30/nepal-must-prioritise-stability-and-rule-based-governance-to-unlock-private-investment>.

21 Asian Development Bank, Country Partnership Strategy: Nepal, 2020-2024, (Manila: Asian Development Bank), September 2019, <https://www.adb.org/sites/default/files/institutional-document/531716/cps-nep-2020-2024.pdf>.

22 Ibid.

Large numbers of skilled and semi-skilled workers migrate abroad in search of better opportunities, creating both immediate labour shortages and long-term gaps in knowledge and expertise.

Weak research ecosystems and limited policy analysis capacity compound these challenges. Nepal's universities and higher education institutions have yet to generate sufficient innovation, policy expertise or technical capacity to support national competitiveness.²³ Research output remains relatively low compared to regional peers and mechanisms for translating academic findings into actionable policy are underdeveloped. This limits policymakers' ability to design evidence-based strategies or anticipate emerging economic and technological trends.

The country also faces persistent human capital challenges. Large numbers of skilled and semi-skilled workers migrate abroad in search of better opportunities, creating both immediate labour shortages and long-term gaps in knowledge and expertise. This 'brain-drain' affects critical sectors such as healthcare, engineering, information technology, reducing domestic capacity to deliver high-quality services and implement technically complex projects.²⁴ Remittances, while providing a crucial financial lifeline, cannot fully substitute for the loss of domestic talent in fostering innovation and institutional resilience.

Addressing these interconnected challenges requires a multifaceted approach. Investment in digital infrastructure is essential to improve efficiency, enhance service delivery and foster innovation. For example, expanding high-speed internet access and e-governance platforms can help streamline bureaucratic processes, reduce corruption and enable greater participation in decision-making at local and national levels.

Stronger linkages between research institutions and government are also critical. Universities and think tanks need incentives to produce policy-relevant research while government agencies must develop mechanisms to integrate evidence into programme design and evaluation.

Public sector governance reforms remain equally important. Streamlining bureaucratic procedures, enhancing accountability mechanisms and reducing the politicisation of administrative

23 United Nations Educational, Scientific and Cultural Organization (UNESCO), "The race against time for smarter development (Chapter 1)", *UNESCO Science Report 2021*, (Paris: UNESCO), 11 June 2021, <https://www.unesco.org/reports/science/2021/en/race4smarter-development>.

24 Government of Nepal, Department of Foreign Employment, *Nepal Labour Migration Report 2022*, (Kathmandu: Department of Foreign Employment), 2022, https://giwmscdnone.gov.np/media/app/public/298/posts/1715249334_10.pdf.

appointments can improve implementation timelines and increase public trust. Finally, developing human capital and innovation ecosystems is indispensable for Nepal's competitiveness. Beyond formal education, this entails promoting vocational training, entrepreneurship and incubation platforms that nurture local talent and facilitate the commercialisation of new ideas.

In sum, Nepal's slow state dynamics, rooted in political instability, weak institutions and human capital challenges, present significant barriers to national competitiveness. However, targeted investments in digital infrastructure, research-government linkages, public sector governance and human capital development can create the conditions for a more agile and strategic state. While these reforms will require sustained commitment and coordination, they are crucial for ensuring that Nepal can effectively navigate the complexities of regional and global economic systems, ultimately enhancing its capacity to exercise agency despite structural constraints.

Beyond formal education, this entails promoting vocational training, entrepreneurship and incubation platforms that nurture local talent and facilitate the commercialisation of new ideas.

Diplomatic Tactics and Strategy Identity

Nepal's negotiations over the BRI cooperation framework agreement with China illustrate the complex diplomatic balancing that smaller states must undertake when engaging major powers. The agreement, signed in December 2024, was widely viewed as an opportunity to expand infrastructure cooperation and economic connectivity.²⁵ However, early drafts of the framework raised concerns regarding its international implications, the scope of cooperation areas and the financing mechanisms associated with potential projects.

As a result, Nepalese negotiators sought to narrow the scope of the agreement to a more manageable set of priorities, including economic cooperation, infrastructure connectivity and trade. They also introduced the term 'aid financing' into the framework to maintain greater flexibility in interpreting funding arrangements.²⁶ This episode illustrates the importance of skilled diplomatic negotiation teams in helping smaller states secure favourable outcomes when dealing with larger partners. It also reflected a longstanding dynamic in Nepal's foreign policy where aid dependency has historically shaped both development planning and diplomatic engagement, requiring negotiators to balance external funding opportunities with domestic policy autonomy.

This reflects broader challenges related to policy execution, bureaucratic coordination and financing arrangements.

Nepal's engagement with the BRI has often been framed as a major opportunity for infrastructure development. However, implementation has been slower than anticipated and several memoranda of understanding signed with China have yet to translate into concrete projects.²⁷ This reflects broader challenges related to policy execution, bureaucratic coordination and financing arrangements. The reduction or closure of programmes supported by organisations such as the US for International Development underscores the limits of reliance on external assistance which can limit policy autonomy and compel Nepal

25 "Nepal and China sign framework for BRI cooperation in Beijing", *The Kathmandu Post*, 5 December 2024, <https://kathmandupost.com/national/2024/12/05/nepal-and-china-sign-framework-for-bri-cooperation-in-beijing>.

26 Government of Nepal, Ministry of Foreign Affairs, "Framework for Belt and Road Cooperation between the Government of Nepal and the Government of the People's Republic of China", (Kathmandu: Ministry of Foreign Affairs), 2024, <https://mofa.gov.np/content/641/framework-for-belt-and-road-cooperation-between/>.

27 Shivam Shekhawat, "BRI in Nepal: An Appraisal", Observer Research Foundation, 5 September 2023, <https://www.orfonline.org/research/bri-in-nepal-an-appraisal>, <https://www.orfonline.org/research/bri-in-nepal-an-appraisal#:~:text=The%20year%202023%20marked%20a,received%20even%20less%20than%20Nepal>.

to seek alternative revenue sources or financing models for development projects.²⁸

At the same time, Nepal must continue to balance its economic and political relations with multiple external partners, including India, China and the US. Many of these relationships remain largely transactional, focused on specific projects or development programmes rather than long-term strategic partnerships. This dynamic is further complicated by shifting global priorities, including the rising importance of regionalisation, digitalisation and emerging technologies such as artificial intelligence, which smaller states must navigate carefully to remain relevant in global networks.

Domestic political dynamics also shape Nepal's diplomatic strategy. Frequent changes in political leadership can complicate the implementation of long-term initiatives and weaken the continuity of foreign policy objectives. In addition, emerging challenges such as disinformation campaigns and foreign influence operations have raised concerns about the vulnerability of democratic institutions in an increasingly competitive geopolitical environment.

Strengthening diplomatic capacity is, therefore, a key priority. This includes developing greater expertise in trade negotiations, climate diplomacy, investment agreements and energy cooperation. Nepal's hydropower sector illustrates the complexity of these negotiations. Initiatives such as the Upper Karnali hydropower project have faced delays, in part due to geopolitical considerations, including downstream concerns raised by India.²⁹ Addressing such issues effectively requires not only technical and legal expertise but also the ability to coordinate across multiple ministries, development partners and regional actors, underscoring the strategic importance of institutional strengthening.

These challenges highlight the need to develop a clearer strategic identity in Nepal's foreign policy. Rather than viewing itself solely as a 'small state', Nepal could adopt a more proactive diplomatic approach that emphasises strategic agency and engagement in global governance.

In addition, emerging challenges such as disinformation campaigns and foreign influence operations have raised concerns about the vulnerability of democratic institutions in an increasingly competitive geopolitical environment.

28 Anil Giri, "In Nepal, US pulls the plug on aid projects worth Rs46.12 billion", *The Kathmandu Post*, 12 March 2025, <https://kathmandupost.com/national/2025/03/12/in-nepal-us-pulls-the-plug-on-aid-projects-worth-rs46-12-billion>.

29 Asian Development Bank, *Nepal Energy Sector Assessment, Strategy and Road Map*, (Manila: Asian Development Bank), 2017, <https://www.adb.org/sites/default/files/publication/356466/nepal-energy-assessment-road-map.pdf>.

Such an approach would involve expanding Nepal's diplomatic outreach beyond its immediate neighbourhood and traditional labour destinations. Platforms such as *Sagarmatha Sambad* (Sagarmatha Dialogue) initiative are potential avenues through which Nepal could shape global discussions on climate change, sustainable development and Himalayan environmental governance.³⁰

30 Government of Nepal, Ministry of Foreign Affairs, "Sagarmatha Call for Action", (Kathmandu: Ministry of Foreign Affairs), 2025, <https://mofa.gov.np/content/1533/sagarmatha-call-for-action/>.

Plurilateralism and Third Neighbours

The concept of world order refers to the set of rules, institutions and power structures that govern interactions between states at the international level. It encompasses formal institutions, such as the UN and the WTO, as well as informal norms, alliances and patterns of influence that shape global behaviour. Following the Second World War, the international order was largely shaped by US-led liberal institutionalism which sought to embed stability and predictability through global governance mechanisms. Institutions such as the UN and the WTO were central to this framework, providing forums for diplomacy, dispute resolution and cooperation on shared challenges.³¹

However, the contemporary international system is increasingly characterised by declining multilateralism and rising geopolitical competition. The post-Cold War optimism about a liberal, rules-based order has given way to a more fragmented system in which power politics and strategic competition increasingly shape state behaviour.³² The Russia-Ukraine War has revived Cold War-like security dynamics in Europe, reintroducing high-stakes military competition and realignments of alliances. Similarly, the strategic rivalry between the US and China now shapes global trade, technology governance and military postures, with far-reaching repercussions. At the same time, regional geopolitical tensions in the Middle East, Africa and the Indo-Pacific further complicate the global environment, creating a landscape of heightened uncertainty for smaller states.

The post-Cold War optimism about a liberal, rules-based order has given way to a more fragmented system in which power politics and strategic competition increasingly shape state behaviour.

Multilateral institutions have struggled to respond effectively to these emerging challenges. The UN Security Council, for example, has often been paralysed in conflicts involving major powers while the WTO's dispute settlement mechanism has weakened, undermining the credibility of international trade law.³³ The inability of global institutions to enforce rules or mediate disputes consistently has heightened risks for small states that rely on international norms to protect their sovereignty

31 G John Ikenberry, "The end of liberal international order?", *International Affairs*, Vol. 94, No.1 (2018): 7-23, https://gji3.scholar.princeton.edu/sites/g/files/toruqf2666/files/gji3/files/inta94_1_2_241_ikenberry.pdf.

32 Ibid.

33 Kristen Hopewell, "Unravelling of the trade legal order: enforcement, defection and the crisis of the WTO dispute settlement system", *International Affairs*, Vol. 101, No. 3 (May 2025): 1103–1117, <https://academic.oup.com/ia/article/101/3/1103/8100243>.

and economic interests. Rising nationalism and inward-focused domestic political priorities, reflected in slogans such as ‘America First’ and ‘Make in India’, have further reduced global support for cooperation while economic fragmentation and the weaponisation of trade, finance and energy are contributing to a broader process of de-globalisation.³⁴

For small states such as Nepal, this evolving environment presents both risks and opportunities.

For small states such as Nepal, this evolving environment presents both risks and opportunities. On one hand, the erosion of multilateral frameworks reduces predictability and protection, increasing pressure on smaller countries to align strategically with major powers or risk marginalisation. Smaller states may find themselves compelled to navigate complex security dilemmas, economic coercion or technological dependencies, without the buffers that robust multilateralism historically provided. On the other hand, small states can still exercise agency through targeted, issue-based coalitions, particularly in areas where they possess comparative advantages or moral authority, such as climate diplomacy, labour migration governance, peacekeeping and environmental conservation.

Situated between India and China, Nepal faces the additional challenge of managing asymmetric bilateral dependencies. Yet it has opportunities to diversify its partnerships beyond this traditional axis, engaging more actively with middle powers and regional partners to enhance diplomatic leverage. Mongolia’s ‘Third Neighbour’ policy offers a useful model. Mongolia has deliberately expanded ties with countries such as Japan, South Korea, Australia and members of the European Union to balance its dependence on its immediate neighbours, thereby strengthening its autonomy in foreign policy.³⁵

Adopting a similar strategy could allow Nepal to broaden its diplomatic options and reduce excessive reliance on any single partner. Engagement could take multiple forms, including trade agreements, technology partnerships, multilateral development initiatives, cultural exchanges and participation in regional and global governance platforms.³⁶ In

34 Bian Sai and Divya Murali, “Trump 2.0 and New Directions in India-US Economic Ties, ISAS Insights No. 762, Institute of South Asian Studies, National University of Singapore, 11 April 2025, <https://www.isas.nus.edu.sg/papers/trump-2-0-and-new-directions-in-india-us-economic-ties/>.

35 Munkh-Ochir Dorjjugder, “Mongolia’s ‘Third Neighbor’ Doctrine and North Korea”, Brookings, 28 January 2011, <https://www.brookings.edu/articles/mongolias-third-neighbor-doctrine-and-north-korea/>.

36 Spencer Feingold, “‘A plurilateral approach’: 3 experts detail how to revive global cooperation”, World Economic Forum, 7 January 2026, <https://www.weforum.org/stories/2025/01/global-cooperation-stalled-experts-deepen-collaboration/>.

addition to economic and political diversification, such an approach could enhance Nepal's capacity to advance its interests in global forums and to shape regional norms.

Initiatives such as *Sagarmatha Sumbad* offer Nepal opportunities to assume a leadership role on regional and global issues. By focusing on Himalayan sustainability, climate change adaptation, disaster risk reduction and biodiversity conservation, Nepal could leverage its geographical and ecological assets to gain international visibility and strategic influence. Leading such initiatives not only advances national interests but also enables Nepal to exercise agency in shaping emerging plurilateral networks that increasingly define global governance in the absence of fully functional multilateral institutions.

Initiatives such as Sagarmatha Sumbad offer Nepal opportunities to assume a leadership role on regional and global issues.

In this context, plurilateralism where small and medium states collaborate on specific issues without requiring full-scale global consensus, offers a pragmatic pathway for Nepal. Rather than relying solely on formal multilateral institutions, Nepal can selectively engage in coalitions to amplify its voice, safeguard its sovereignty and enhance its strategic flexibility. By combining a third-neighbour approach with targeted leadership in issue-based networks, Nepal can navigate a complex and competitive international system while maintaining autonomy and relevance.

Conclusion

The international order is in transition. Whether this transition leads to multipolarity, fragmented disorder or renewed spheres-of-influence politics remains uncertain. What is already clear is that smaller states face a more demanding strategic environment. Established multilateral safeguards are weaker. Rule-making is becoming less predictable. Economic and strategic competition are increasingly intertwined.

Agency remains possible but only when supported by strategic clarity, negotiation capacity, institutional coherence and long-term policy discipline.

For Nepal, these pressures are intensified by geography, structural dependence and domestic institutional weakness. Yet vulnerability alone does not define Nepal's position. Smaller states are not passive actors by default. Agency remains possible but only when supported by strategic clarity, negotiation capacity, institutional coherence and long-term policy discipline.

Nepal's foreign policy traditions, including non-alignment, balancing, strategic caution and layered engagement, remain relevant but they require adaptation. The current environment is less forgiving of ambiguity without capacity. Diplomatic positioning alone is insufficient if implementation remains weak.

The most important strategic lesson is internal. External pressures are real but domestic capability determines how those pressures are managed. Governance quality, institutional strength, policy continuity and technical competence increasingly shape diplomatic outcomes. Negotiation capacity is no longer a secondary skill. For smaller states, it is a core strategic asset.

Nepal's opportunities remain significant. Climate diplomacy, hydropower, migration, diaspora networks, green finance, ecological leadership and regional connectivity all offer potential platforms for greater strategic visibility. However, opportunities require preparation. Strategic relevance must be converted into policy advantage through deliberate statecraft.

The challenge is, therefore, not simply how Nepal survives geopolitical churn but how it positions itself within it. Smaller states cannot control the direction of global power transitions. They can, however, shape how they respond. For Nepal, the central task is to move from reactive adaptation toward strategic positioning.

Appendix 1

List of Speakers

1. Ameet Dhakal, Editor-in-Chief, *Setopati*, Kathmandu, Nepal
2. Amish Mulmi, Editor and Writer, Kathmandu, Nepal
3. Apekshya Shah, Assistant Professor, Central Department of International Relations and Diplomacy, Tribhuvan University, Kathmandu, Nepal
4. Biswash Gauchan, Executive Director, Institute for Integrated Development Studies, Kathmandu, Nepal
5. Iqbal Singh Sevea, Director, Institute of South Asian Studies, National University of Singapore
6. Lucky Sherpa, Former Ambassador of Nepal to Australia and New Zealand
7. Madhu Raman Acharya, Former Foreign Secretary, Government of Nepal, Kathmandu, Nepal
8. Mahesh Raj Bhatt, Research Officer, Centre for South Asian Studies, Kathmandu, Nepal
9. Pradeep Panthi, Research Fellow, Policy Research Institute, Kathmandu, Nepal
10. Puspa Sharma, Senior Research Fellow, Institute of South Asian Studies, National University of Singapore
11. Semanta Dahal, Chair, Purak Asia, Kathmandu, Nepal
12. Shweta Karki, Assistant Professor, Central Department of International Relations and Diplomacy, Tribhuvan University, Kathmandu, Nepal
13. Sudip Bhaju, Executive Board Member, Nepal Economic Forum, Kathmandu, Nepal
14. Sujeev Shakya, Chair, Nepal Economic Forum, Kathmandu, Nepal; and Non-Resident Senior Fellow, Institute of South Asian Studies, National University of Singapore
15. Vijay Kanta Karna, Executive Chair, Centre for Social Innovation and Foreign Policy, Kathmandu, Nepal; and Former Ambassador of Nepal to Denmark

Appendix 2

About the Editors

Dr Puspa Sharma is a Senior Research Fellow at the Institute of South Asian Studies in the National University of Singapore. He has more than two decades of experience in policy research on trade and development issues and has provided expert services to the government of Nepal and several international organisations such as the Asian Development Bank, United Nations (UN) Economic and Social Commission for Asia and the Pacific and UN Office of the High Representative for Least-Developed Countries, Landlocked Developing Countries and Small Island Developing States.

Dr Sharma was an expert member of the teams that prepared the Nepal Trade Integration Strategy 2023 and Nepal's Trade Logistics Development Policy 2022 for the Nepal government. From 2009 to 2021, he worked at the South Asia Watch on Trade, Economics and Environment (SAWTEE), a think tank based in Kathmandu, in various capacities, latest as its Executive Director. He was also the Editor-in-Chief of SAWTEE's flagship publication, *Trade Insight*. He is a member of the International Advisory Network of the Forum on Trade, Environment & the SDGs, an initiative of The Graduate Institute, Geneva, and a member of the Standing Group on Food Policy and Governance, European Consortium of Political Research.

Dr Sharma has published articles in esteemed peer-reviewed journals such as *Agriculture and Human Values*, *Journal of Comparative Policy Analysis: Research and Practice* and *Globalizations*. He has also authored, reviewed and edited books, book chapters, working papers, research reports, policy briefs, briefing papers and articles on trade, least developed countries graduation, landlocked developing countries' concerns, agriculture and food systems, regional integration, paperless trade and other development issues focusing Nepal and South Asia.

He holds a PhD in Public Policy from the Australian National University which he earned as an Australia Awards scholar. He earned his Master of Art (MA) degree in Global Finance, Trade and Economic Integration from the University of Denver, Colorado, as a Fulbright student. He also holds an MA degree in Economics from the Tribhuvan University, Kathmandu.

Ms Kanika Kaur is a Research Analyst at the Institute of South Asian Studies in the National University of Singapore (NUS). She holds a Master's degree in International Affairs from the Lee Kuan Yew School of Public Policy in NUS, with a background in political science and economics.

Her research focuses on foreign policy analysis, South Asian geopolitics and traditional security, with particular interest in India-China relations, strategic technologies and Indian foreign policy.

Ms Kaur is proficient in qualitative and quantitative analysis using R, Python and Excel, bringing a data-driven perspective to policy research and analysis.

Ms Devyani Chaturvedi is a former Research Analyst at the Institute of South Asian Studies in the National University of Singapore (NUS). Her work focuses on India's foreign and economic policy.

Ms Chaturvedi is the co-editor of *The EU as a Security Actor in the Indo-Pacific: Perceptions and Responses from the Region* (Springer Nature, 2024) and has contributed chapters to several publications, including *Biden and Beyond: The United States Rethinks South Asia* (World Scientific, 2024), *India and the Future of G20: Shaping Policies for a Better World* (Bloomsbury, 2023) and *Multilateralism in the Indo-Pacific: Conceptual and Operational Challenges* (Routledge, 2022). Her research has also been featured in policy reports such as *Infrastructure in India: Investment Priorities, Opportunities and Key Challenges* (FCDO, 2021) and *Evaluation of India's Faceless E-Assessment Tax Scheme* (NCAER, 2022).

Ms Chaturvedi holds a Master's degree in International Affairs from the Lee Kuan Yew School of Public Policy in NUS, specialising in International Economics and Development.

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