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# A Framework to Assess India's Economic Diplomacy in its Neighbourhood

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This paper assesses India's economic diplomacy toolkit toward its neighbourhood and decodes the best options in which to amplify investment. The analysis is based on a framework studying the degree of input and quality of outcome of India's varied economic policy tools vis-à-vis six neighbours: Bangladesh, Bhutan, Maldives, Myanmar, Nepal and Sri Lanka.

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# Executive Summary

This paper articulates three overarching goals that must underpin India's neighbourhood economic diplomacy. First is the pursuit of regional stability through economic integration and partnerships, which in turn contribute to India's domestic growth. Second is the consolidation of India's position as the preeminent regional power, an ambition that inherently involves managing and mitigating the challenge posed by China. Third is the cultivation of goodwill and regional reputation, recognising that intangible assets, such as credibility and trust, enhance India's influence and legitimacy.

By applying a framework to assess India's economic diplomacy toolkit in the neighbourhood, the paper concludes that:

- Low-input tools require less diplomatic wrangling and lower-level political cooperation with partner countries. Whether or not the impact of low-input tools is high or low, India must continue to invest in these tools in large numbers, to gradually enhance the degree of interdependence between itself and the neighbouring economy.
- If a high-input tool can yield significant impact and sustained outcomes, it must be invested in and prioritised over multiple low-input, high-impact, or comforting-but-redundant high-input tools. In other words, India's neighbourhood policy may want to experiment with previously untouched measures to fulfil its objectives.

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# I. Introduction

The past year has witnessed a series of cascading political and security crises across India's immediate neighbourhood, the most acute being the Pahalgam terror attack escalating into an India–Pakistan military confrontation. Nepal has seen renewed pro-monarchy protests, while Bangladesh faces a deepening constitutional crisis. Meanwhile, Myanmar continues to grapple with intensifying ethnic insurgency. These developments highlight the fragility of the region's political, security and institutional landscape.

For India, the implications are direct and pressing. These upheavals have exposed the limits of existing diplomatic mechanisms, challenged traditional assumptions of regional alignment, and revealed significant strategic vacuums that external actors, like China, are eager to fill. India's rise as a global power is contingent upon the stability and prosperity of its immediate neighbourhood. Former Foreign Secretary Harsh Vardhan Shringla noted<sup>1</sup> in 2022 that India's ability to shape outcomes beyond its borders is directly linked to its engagement with its region.

India's Neighbourhood First policy,<sup>2</sup> formally articulated in 2008, was intended to prioritise regional cooperation, connectivity, and development in the Indian subcontinent. While India has made significant strides, such as in energy cooperation with Nepal, development projects in Bhutan, and financial assistance to Sri Lanka, regional ties remain vulnerable to economic turbulence, political instability, and external influence. Regional leadership without power and legitimacy is, after all, unsustainable.

Against this backdrop, economic diplomacy has emerged as India's principal instrument for engaging with its neighbours. Through trade agreements, concessional finance, development aid, cross-border infrastructure, capacity-building, and people-to-people exchanges, India has sought to embed itself as the preferred partner and anchor.

This document evaluates the objectives, operational tools, and challenges of India's economic diplomacy with its neighbours. It examines India's use of trade enhancement and restrictions, investment, grants, aid and labour mobility to foster regional stability and influence. Finally, it proposes a framework through which to assess India's toolkit. This assessment can help reconsider the choice of instruments and their deployment to better align with India's neighbourhood objectives.

## II. What Should the Objectives of India's Neighbourhood Economic Diplomacy Be?

Given the asymmetrical power dynamics in the region, smaller neighbours often perceive India's actions through a lens of suspicion. India's aim in its neighbourhood is an amalgamation of strategic, economic and cultural objectives, each weighing heavily on the other. The realist pursuit of security and regional dominance, the liberal emphasis on economic interdependence and development, and the constructivist focus on shared cultural identities together form the foundation of India's neighbourhood policy.

This paper argues that, in addition to the officially stated objectives of the Indian government, three overarching goals must underpin India's neighbourhood economic diplomacy.

- First, the pursuit of regional stability through economic integration and partnerships, which in turn contribute to India's domestic growth;
- second, the consolidation of India's position as the preeminent regional power, an ambition that inherently involves managing and mitigating the challenge posed by China; and
- third, the cultivation of goodwill and regional reputation, recognising that intangible assets, such as credibility and trust, enhance India's ability to exert influence in the neighbourhood.

## **II.A. Regional Stability and Domestic Growth Through Economic Integration**

The liberal school of international relations has long posited that economic interdependence reduces the incentives for conflict. However, the Indian subcontinent remains one of the least economically integrated regions globally, with intra-regional trade accounting for merely 5% of total trade.<sup>3</sup> This is in stark contrast to 26% in ASEAN and over 50% in the European Union. Despite advocating regional cooperation, India's protective tariff regimes, limited market access for neighbours, and security-centric border controls have constrained the depth of trade flows.

Tariff levels in the region remain significantly above global averages,<sup>4</sup> with an average applied tariff of 13.6%, compared to 2.5% in the European Union and 1.5% in East Asia. Such high trade barriers not only discourage formal commerce but also fuel informal and illicit trade channels. Hence, there is a pressing need to recalibrate trade policy towards greater openness and predictability.

Further, interlinked economies reduce friction, as nations become stakeholders in each other's prosperity. India's support for integrated check posts, cross-border electricity trade, and regional rail network exemplifies how integration has been successful. Informal markets in border areas, especially border haats,<sup>5</sup> have helped facilitate small-scale trade in agro-products, consumer goods, and textiles while supporting local livelihoods and micro-enterprises.

Border states in India, including those in the Northeast, Tamil Nadu, and Gujarat, benefit directly from enhanced regional trade and people-to-people connections. To illustrate, hydropower imports from Bhutan and Nepal have helped meet energy demands in Bihar and northern India, stabilising grid supply and reducing costs. Hence, for a country of India's size and ambition, the neighbourhood is not a liability to manage, but a resource to cultivate.

## **II.B. To Become a Preponderant Regional Power**

India's willingness to project power in a volatile neighbourhood is connected with positioning itself as a regional 'net security provider'. Its main challenger in this regard is China, and one can already observe an expansion in Chinese influence in India's neighbourhood. With changes in governments, there are shifts in political loyalties as well. More recently, new governments in Nepal, Bangladesh, Myanmar, and the Maldives are investing in political proximity with China.

China has deeply invested in the defence programmes of India's neighbours. With Sri Lanka, for example,<sup>6</sup> China has exported bomb squad equipment and a range of military aircraft. India has often also opposed China's potential dual-use civilian scientific research vessels making port calls in Sri Lanka.

With Bangladesh, China has seen a rise in trade of Man-Portable Air Defence Systems, and Beijing has invested<sup>7</sup> heavily in building the country's first submarine base in Cox's Bazaar, the BNS Sheikh Hasina, which was inaugurated in 2023. In Myanmar's case, the junta government's dependence on Chinese weapons is massive, given the overall international boycott on sales of sensitive systems and technologies to the country.



China is one of the largest trading partners of most of India's neighbours, and the largest one for the Maldives and Bangladesh. It has also invested in infrastructure development projects across the neighbourhood, many of which are a part of its flagship Belt and Road Initiative (BRI). From leasing the Lankan port of Hambantota for a period of 99 years in 2017, to becoming the largest overseas investor in the Maldives, China has demonstrated its ability to establish economic influence through its deep coffers. In this context, India's growing insecurity and its desire to be the preferred security partner for its neighbours make achieving regional preponderance essential.

## **II.C. Securing goodwill and reputation**

In a world order where values once considered sacrosanct for the functioning of the international system are now subject to constant contestation and rapid transformation, it is essential for a nation to possess a status and reputation that precede its actions. In this context, the perception of India's intentions, reliability, and capacity is an important asset. A positive reputation supports informal leadership, where India is looked to as a crisis manager, a mediator, and a development enabler, even without treaty-based authority. Securing regional legitimacy is also essential to coordinate responses to transboundary challenges such as climate change, migration, and public health.

In this regard, the Indian Council for Cultural Relations (ICCR) and the Indian Technical and Economic Cooperation (ITEC) have been two important initiatives by the government.

- The Indian Council for Cultural Relations, which facilitates exchanges of academics, artists, and performers, has created opportunities for societal engagement beyond politics.
- Similarly, the Indian Technical and Economic Cooperation, which provides<sup>8</sup> training courses to government officials, has enhanced collaboration in sectors such as IT, agriculture, health, governance, and engineering. Recognising the specific developmental needs of each country, ITEC has also provided customised programmes for the Maldives, Nepal and Sri Lanka. Further, their alumni networks, many of whom rise to influential positions in government and industry, form a durable constituency of pro-India sentiment and institutional links.

This dense web of linguistic, ethnic, cultural, and historical ties that India shares with its neighbours is capable of generating both trust and resentment, depending on how they are managed. In recent years, anti-India sentiment in some countries has challenged India's image. These perceptions, whether grounded or not, affect how Indian initiatives are received, politicised, or blocked. For example, Madhesi communities in Nepal, with linguistic and familial ties to India, have been a point of contention between Kathmandu and New Delhi. Hence, reputation also acts as a deterrent against hostile narratives, and as a magnet for advanced cooperation.

Investing in educational exchanges, tourism, and diaspora engagement is an important aspect of India's economic and cultural diplomacy. Civil societies, youth, and media ecosystems are all powerful drivers of international reputation. A favourable perception among these groups builds social capital that outlasts governments and political cycles.

### III. The Government's Stated Vision

It is important to note how the Indian government has articulated its policy objectives in this domain. India's regional approach has consistently emphasised themes such as economic cooperation for mutual growth, connectivity and development partnerships. These stated goals are regularly reiterated in official documents and speeches by the leadership, and through frameworks like the Neighbourhood First and Act East policies. The following section identifies these core objectives, highlighting both areas of progress and persisting gaps.

#### III.A. To Be a 'Net Security Provider' and 'First Responder'

The concept of India aspiring to be a "Net Security Provider" in the Indian Ocean Region (IOR) first gained traction during the early 2000s, especially under the leadership of Prime Minister Manmohan Singh. It has since been sharpened by successive governments. The term was explicitly used<sup>9</sup> by US Secretary of Defence Robert Gates at the 2009 Shangri-La Dialogue and later adopted by the Indian strategic affairs community, notably being reflected in India's Maritime Security Strategy<sup>10</sup> (Indian Navy, 2015).

At its core, the ambition reflects India's evolving self-perception as a responsible power capable of contributing to regional and global stability, particularly in the IOR, and by extension, the Indo-Pacific.

India has also positioned itself as a ‘first responder’ in the region by providing Humanitarian Assistance & Disaster Relief (HA/DR) for its neighbours. As the Ministry of External Affairs (MEA) notes, “*The emerging concept of India as a ‘first responder’ reflects the country’s growing capability and increasing willingness to assume the role of a leading power.*” Further, Defence Minister Rajnath Singh argued in 2022, “*We have strengthened multilateral partnerships through engagement via regional mechanisms. This has improved interoperability enabling faster response in crisis situations.*”<sup>11</sup>

As is evident from the statements, the two-fold objective India should aim to achieve by positioning itself as a ‘net security provider’ and ‘first responder’ is to foster a culture of interoperability and interdependence between itself and its relatively smaller neighbours, and to project power, capability and willingness. For example, the Vaccine Maitri initiative during the COVID-19 pandemic showcased India’s willingness to act both as a responsible global and regional player.

The tools referenced by both the Defence and External Affairs ministries to achieve this goal include, but are not limited to:

- Natural disaster deployment: Indian armed forces have been known<sup>12</sup> to contribute naval vessels, helicopters, aeroplanes, and military personnel to countries such as Sri Lanka and Nepal to provide relief in the aftermath of cyclones and earthquakes. India’s National Disaster Response Force (NDRF) also prepares ‘rescue and relief’ teams to engage in HA/DR operations. Further, India has also dealt in the supply of critical goods such as rice to disaster-ridden areas in the

neighbourhood, especially in Nepal (which is quite earthquake-prone), as well as fresh drinking water in the Maldives.

- Lines of Credit: India has assisted nation-building in its neighbourhood by supplying monetary support in the form of billions of dollars' worth of lines of credit. In the aftermath of the end of armed conflict in Sri Lanka in 2009, India provided USD 1 billion in lines of credit and grants for “projects<sup>13</sup> in education, health, transport connectivity, and training.”
- Refugee flow: The MEA has argued<sup>14</sup> in the past that India has a “default open doors policy” for displaced persons in its neighbourhood and that India is at the centre of such persons' routes to safety.

### III.B. To Foster Institutional and Political Stability

Given that India's neighbourhood has witnessed a mix of military coups, civil wars, fragile governments, weak institutions, and insurgent movements, cultivating institutional and political stability through elite co-option and joint institution-building can be a challenge. The repeated experience of spillover threats, such as terrorism, illegal migration, humanitarian crises, and piracy, shows that instability in neighbouring countries inevitably destabilises India's own internal and external security environment. Hence, stability-building is intrinsically tied to India's national interests.

The MEA states that India acts as a ‘first support responder’ and a ‘democratic first responder’ when its neighbouring countries face the risk of a coup or instability. India often cites the example of 1988 ‘Operation Cactus’, conducted in Malé, where the armed forces were deployed to secure the

leadership of President Gayoom against an attempted coup by Sri Lankan Tamil mercenaries. In Bangladesh's case, India invested significantly in maintaining Sheikh Hasina as a "tested friend,"<sup>15</sup> ensuring economic exchanges flourished.

Stable governments are better able to participate in regional connectivity projects, trade pacts, and investment agreements, ensuring continuity and legal protections for Indian businesses. The main challenge, however, is the fact that India cannot prevent political upheavals and changes in domestic political sentiment across the region, which ultimately test how strong institutional links between India and its neighbours are:

- In Bangladesh's case, the 'Oust Hasina' campaign in August 2024, triggered by Hasina's unwillingness to revoke employment quotas for relatives of 1971 war veterans, launched a wave of protests that India couldn't control and struggled to adapt to. As per a meeting<sup>16</sup> led by Bangladesh's new interim Chief Adviser, Mohamed Yunus, in December 2024, the prevailing sentiment in the country is against India. "*The meeting condemned India's attempts to establish cultural hegemony over Bangladesh and its economic harassment of our country,*" a Bangladeshi government media statement said afterwards.
- In Nepal, while positive relations flourished in the aftermath of the lifting of the 2015 economic blockade by India, more recently, political changes have overturned diplomatic progress. With Prime Minister KP Oli's ascent to power in Nepal, the political atmosphere in the Himalayan nation has become more aligned with the Marxist-Leninist ideological leaning that China represents. This has also translated into

Oli visiting Beijing for his first foreign trip since his July 2024 swearing-in ceremony, breaking a long tradition of Nepali PMs visiting Delhi for this symbolic first trip.

- In Maldives and Sri Lanka, respectively, political turmoil has been a result of political struggle and economic flux. Muhammad Gayoom, Maldives 3rd President, served in the role with a heavy hand for 30 years. The next President, Mohamed Nasheed, came into power in 2008 but had his Cabinet resign in 2010 due to a struggle with opposition parties in the parliament, the Majlis.<sup>17</sup> He subsequently resigned in 2021 after controversy erupted opposing his arrest of the Maldivian Chief Justice.
- In 2013 and 2014, elections were mired in confrontations and Nasheed's successor, Mohamed Waheed, lasted only a year in office. Subsequently, the presidencies of Abdullah Yameen, Ibrahim Solih, and now, Mohamed Muizzu, have seen stronger electoral processes and stability in the presidential office. However, Yameen has been charged with corruption,<sup>18</sup> as the country's debt to China rose in his tenure. And so, Solih maintained a balanced approach to China, until Muizzu campaigned against such nuance and won a majority both as President and in the Majlis.
- In Sri Lanka, the economic crisis that began in 2022 continues to have drastic aftereffects today, especially in the form of high inflation, depleted foreign exchange reserves, and a sovereign debt default. As a result, the new government under Anura Dissanayake has adopted a rigorous economic growth agenda, bringing it closer to China.<sup>19</sup>

### III.C. To Enable Mutual Growth

Since independence, India has viewed peace and prosperity in its immediate neighbourhood as essential to its own development. However, this idea has become more institutionalised over the last two decades, especially under the ‘Neighbourhood First’ policy. The policy’s antecedents can be traced back to the Gujral Doctrine of the 1990s, which emphasised non-reciprocal engagement with smaller neighbours.

At the heart of this policy lies the principle that India’s rise cannot occur in isolation. It must be embedded within a prosperous and interconnected subcontinent and IOR. Hence, enabling mutual growth, economic, social, and infrastructural, is a core goal of India’s external strategy.

India promotes the idea that the ‘Neighbourhood First’ policy attempts to stimulate the ‘holistic economic development’ of the region. Not only are assistance programmes a part of this strategy to foster economic growth and interdependence, but there is also great emphasis on joint infrastructure, connectivity projects and sustainability-related development projects. As specified in a response<sup>20</sup> by External Affairs Minister S. Jaishankar to a starred question in the Lok Sabha, the following projects are of vital significance to India’s ‘mutual growth’ strategy:

- Several development cooperation projects in Bangladesh in the areas of cross-border power, energy and transport linkages.
- Assistance to Bhutan for capacity building and in the development of its hydropower resources, as well as cross-border connectivity linkages.



These may also include energy, rail links, road, trade infrastructure and digital connectivity;

- With the Maldives, cooperation has focused on maritime security, connectivity, people-to-people exchange, and the creation of community-building infrastructure projects, besides assistance to overcome financial instability.
- Assistance to Myanmar for several connectivity infrastructure development projects and capacity building, besides humanitarian relief and aid to help it recover from natural disasters.
- A very elaborate programme of development cooperation with Nepal aimed at promoting connectivity and developing economic, energy, digital and cultural ties, including through the implementation of High Impact Community Development Projects (HICDP) in building hospitals, schools, colleges, drinking water facilities, sanitation, drainage, rural electrification, and hydropower, so as to improve the overall quality of life at the local level; and
- Cooperation with Sri Lanka, including connectivity, agriculture, power, education, human resource development, culture and economic engagement, as well as a significant financial assistance programme.

There are two important challenges to consider in bringing such projects to fruition. The first is a capability gap vis-à-vis the fulfilment of promised developmental projects. The slow spread<sup>21</sup> of rail connectivity in border areas (especially in the Northeastern states of India), lack of bilateral coordination (especially with governments in Bangladesh, Nepal and Myanmar), poor<sup>22</sup> financial viability, and inability to overcome terrain challenges are a few

reasons why India's connectivity projects with its neighbours have stalled. Second, which is more of an exacerbating factor, is the lack of political stability in the neighbourhood, which leads to a breakdown of institutional communication between India and the relevant country. This is true in the cases of the junta government in Myanmar and Yunus's new government in Bangladesh.

### III.D. To Build Trust

Because of a massive power differential between India and its neighbours, there is a general sentiment of lack of trust. This is captured in narratives that India projects itself to be a 'big brother'<sup>23</sup> towards its smaller neighbours. Hence, it becomes vital for India to invest in confidence and trust-building measures to give an impetus to all other objectives. There are multiple pathways to building said confidence:

- **People-centric diplomacy:** People's goodwill towards India is an important parameter for enhancing state-to-state relations. In Afghanistan's case, for example, the goodwill of the people towards India, due to the latter's investment in nation-building projects such as hospitals and schools, was a potential reason why the Taliban proposed continued engagement with Delhi. Cultivating such engagement requires ease of tourism, investment in people-centric projects, and continued exchange of journalists and scholars. India's current visa processes for some of its neighbours, especially Bangladesh, restrict free-flowing people-to-people exchanges (including medical tourists<sup>24</sup> and journalists<sup>25</sup>). At the same time, India has valid concerns

to raise surrounding the influx of illegal immigrants, which requires state-to-state collaboration on security and documentation.

- **Talent training:** India has the institutional base to train students from neighbouring countries in its universities, as well as military officials in its defence academies.
- **Leveraging cultural similarities:** India's main ambition with SAARC was to foster a 'regional identity' and leverage cultural similarities to enhance unity. However, given persistent India-Pakistan tensions, SAARC remains defunct. There are no active endeavours that focus on identity-building. The Indian Council on Cultural Relations also has an important role to play, given that most of India's neighbours have individual scholarship programmes designed by ICCR for their students at Indian educational institutions. ICCR also runs cultural centres in Malé and Dhaka.

Clearly, there is an overlap between stated objectives and the vision proposed in this paper. The priority, going forward, is the amplification of efforts toward regional economic integration and the building of goodwill, for which an extensive toolkit on trade enhancement and restriction, capacity building, economic support, and cultural engagement is essential.

## IV. What does the Government's Current Economic Diplomacy Toolkit Entail?

The government's toolkit is a multidimensional apparatus that extends beyond conventional trade agreements. The range of instruments includes, broadly, trade enhancement measures, use of trade restrictions, bilateral and regional investments, monetary and development assistance, and people-to-people mobility initiatives.

### IV.A. India's Economic Diplomacy Toolkit (Table 1)

Countries	Bangladesh	Bhutan	Maldives	Myanmar	Nepal	Sri Lanka
Trade Enhancement						
MOUs	2 MoUs signed in 2023 on cross-border payment transactions <sup>26</sup>	2 MoUs signed on energy cooperation in 2024, environment in 2021 <sup>27</sup> and space cooperation in 2020 <sup>28</sup>	Several MoUs on cooperation in the fields of security, disaster management and capacity building signed in 2022 <sup>29</sup>	Several MoUs on the prevention of human trafficking, health research and communications signed in 2020 <sup>30</sup>	Several MoUs on cross border payments, petroleum infrastructure and a hydroelectricity project signed in 2023 <sup>31</sup>	2 MoUs on hybrid renewable energy and fisheries signed in 2022 <sup>32</sup>

Trade Facilitation Agreements	India-Bangladesh 2020 Trade Agreement: talks for a Comprehensive Economic Partnership <sup>33</sup> ; India-Bangladesh MoU of April 2017 enables cross-border trade through the establishment of 'Border Haats' in remote villages on the agree 'line zero' of the border <sup>34</sup>	India-Bhutan Agreement on Trade, Commerce and Transit 2016 <sup>35</sup> ; Agreement between FSSAI and BFDA to facilitate food and agricultural exports <sup>36</sup>	Discussions initiated for FTA, Currency Swap Agreement 2024 <sup>37</sup>	Agreement on India-Myanmar Border Trade 1995 <sup>38</sup>	Indo-Nepal Treaty of Trade 2009 <sup>39</sup> , Treaty of Transit 2023 <sup>40</sup> , Agreement for Cooperation to Control Unauthorised Trade 2009 <sup>41</sup>	India Sri Lanka Free Trade Agreement 2000: talks for an Economic and Trade Cooperation Agreement <sup>42</sup>
Easing or Designating Export Quotas	Under SAFTA, India has granted duty-free quota quota-free access to Bangladesh on all items except alcohol and tobacco <sup>43</sup>	Export quota of 79,000 metric tonnes of non-basmati white rice designated for Bhutan (in 2023) <sup>44</sup>	Export quotas on potatoes, onions, eggs, rice, sugar, and pulses eased; export restrictions lifted in 2024 <sup>45</sup>	Annual quota of 2,50,000 MT of Urad and 1,00,000 MT of Toor dal agreed for export from India to Myanmar from FY 2022 to FY 2026 <sup>46</sup>	DGFT Export Quotas (January 2025) on 200,000 tonnes of wheat designated for Nepal <sup>47</sup>	Quotas on certain tariff lines guaranteed since June 2007 – 15 mn tonnes of Tea, Garments and 528 types of Textiles <sup>48</sup>

Trade Restrictions						
Tariff Barriers	Some products under India-Bangladesh trade categories, such as agriculture, textiles, machinery, electronics, auto parts, iron and steel, electricity and plastics, fall outside the ambit of SAFTA and are subject to full tariffs <sup>49</sup>	Minimal; primarily NTBs (discussed below)	Primarily Export Restrictions (discussed below); there is also a lack of an FTA (which is currently under deliberation)	Primarily NTBs and export restrictions (discussed below)	Tariff rate quotas on the imports of vegetable ghee, acrylic yarn, copper products and zinc oxide <sup>50</sup>	India's negative list – 431 product lines, Sri Lanka's – 1220 product lines <sup>51</sup>
Export Restrictions	Curbs on export of staple foods such as wheat, rice and sugar since 2022, leading to inflation in food prices in Bangladesh, and illegal smuggling across the border <sup>52</sup>	Minimal	Export bans on wheat, non-basmati rice, and onions in 2022; mitigated by increases in quotas in 2024 <sup>53</sup>	Restricted cross-border trade overall due to the junta government in Myanmar; quantitative restrictions on imports of tubers and beans since 2017 <sup>54</sup>	Minimal	Minimal
Non-Tariff Barriers	Rules of origin (which SAFTA partners are not excluded from), customs inefficiencies, and excessive paperwork <sup>55</sup>	Bhutan Food and Drug Authority (BAFRA) export certificates are not recognised by	DGFT imposes port restrictions on imports from the Maldives due to political tensions (since	Stringent SPS and TBT measures, as well as quality standards, strict import licensing <sup>58</sup>	NTBs such as SPS and Technical Barriers to Trade (TBT) on animal products, agro-	ISFTA does not exclude NTBs such as sanitary and phytosanitary measures <sup>60</sup>

		FSSAI (especially in processed foods) <sup>56</sup>	April 2024) <sup>57</sup>		products, minerals, fuels, chemicals, plastics, etc. <sup>59</sup>	
<b>Regional Integration/ Infrastructure Development Initiatives</b>	BIMSTEC; In November 2023, the two sides virtually inaugurated the Akhaura–Agartala cross-border rail link and the Khulna–Mongla Port rail line <sup>61</sup>	BIMSTEC; Inauguration in December 2024 of an immigration check post on the border to facilitate regional tourism and trade <sup>62</sup>	BIMSTEC; USD 80 mn project on land reclamation in Addu; USD 70 mn roads and drainage development project across the Maldives; India has contributed monetarily to the ‘Greater Malé Connectivity Project’ <sup>63</sup>	BIMSTEC; Project Agreement for Construction of a Modern Integrated Checkpost at Tamu in Myanmar; <sup>64</sup> IMT trilateral paused; Mekong–India Economic Corridor (still under deliberation)	BIMSTEC; construction of integrated check posts at Birgunj and Biratnagar, the Motihari–Amlekhgunj petroleum pipeline and Terai road projects; <sup>65</sup> India granted NRs 474 million to support 12 High Impact Community Development Projects in Nepal (Sept. ‘24) <sup>66</sup>	BIMSTEC; Ferry services between Tamil Nadu and KKS since October 2023; resumption of airlink between Chennai and Jaffna since December 2022 <sup>67</sup>
<b>Investments</b>						
Overseas Direct Investment (April 2000– September 2024) <sup>68</sup>	US\$ 765 Million	US\$ 81 Million	US\$ 499 Million	US\$ 1733 Million	US\$ 259 Million	US\$ 6,270 Million

Foreign Direct Investment (Inflow) 2000–2024 <sup>69</sup>	US\$ 0.08 Million	No significant inflow	US\$ 12.31 Million	US\$ 9.02 Million	US\$ 7.39 Million	US\$ 98.20 Million
<b>Monetary Assistance</b>						
Budget Allocated Aid (Actual, in Rs. Crore, FY 2023–24) – pertains to total grants and loans disbursed <sup>70</sup>	157.63	2332.02	823.83	352.96	657.38	119.37
Lines of Credit	US\$ 7.862 billion <sup>71</sup>	Data unavailable	US\$ 1.43 billion <sup>72</sup>	US\$ 745 million <sup>73</sup>	US\$ 1.65 billion <sup>74</sup>	US\$ 2 billion <sup>75</sup>
<b>People-to-People Mobility</b>						
Visa Requirements	Employment and Business Visa required, India–Bangladesh Joint Working Group on Migration <sup>76</sup>	Free Movement Regime under India–Bhutan Friendship Treaty; full work and residence rights <sup>77</sup>	Visa-free for 90 days for Indians visiting the Maldives; a Work visa is needed for employment <sup>78</sup>	Employment and Business visas are required. Free Movement Regime terminated in 2024; replaced with restricted border-pass system <sup>79</sup>	Free Movement Regime under the Indo–Nepal Treaty of Peace and Friendship; full work and residence rights <sup>80</sup>	Standard visa procedures apply for Employment and Business visas <sup>81</sup>
% share in all Foreign Tourist Arrivals to India <sup>82</sup>	22.26 (2023)	0.32 (2022)	1.11 (2022)	0.25 (2022)	2.05 (2023)	2.94 (2023)



## IV.B. Not Without Challenges

India's engagement with its neighbourhood is shaped by an interplay of military, economic, and political challenges, each of which constrains its ability to exercise consistent regional influence and leadership.

The first challenge is that while India has deployed naval, aerial and ground forces to act as a net security provider in the region, it has not emerged as the primary go-to regional power for military assistance. For example, India's relatively nascent domestic arms production base has meant that it is not the most popular or preferred defence import partner for its neighbours. Its military training and joint exercise endeavours are also matched by those of the US and China. Often, military deployment is not seen positively in neighbouring countries – an example being the negative sentiment against the deployment of Indian security forces in the Maldives. President Mohamed Muizzu's recent win to the seats of power in Malé partially came about due to the 'India Out' campaign that he popularised.<sup>83</sup> Subsequently, Indian armed forces officials have also been replaced by "civilian technical officers" due to political pressure.

Secondly, Lines of Credit are not grants; instead, they are 'soft loans'<sup>84</sup> liable to be paid back based on an interest rate specified to the debtor by the EXIM Bank. Given that countries that are some of the highest recipients of such LoCs, such as Bangladesh and Sri Lanka, are often struck by economic adversities, repayment remains a challenge.

Further, while it is true that India is home<sup>85</sup> to one of the largest refugee populations in the region, its arbitrary policy vis-à-vis the treatment of refugees has led to concerns surrounding discrimination. There is a lack of domestic capability to provide the necessary conditions for refugees' equal and rightful treatment, as specified in the 1951 UN Convention on the Status of Refugees and its 1967 Protocol. This is partially exacerbated by the fact that India is not a signatory to either and does not have an overarching legal framework on refugees and displaced persons.

## **V. A Framework to Assess India's Economic Diplomacy in the Neighbourhood**

Building on India's existing economic diplomacy toolkit, this framework evaluates the effectiveness of different instruments by analysing two dimensions: input and impact.

- “Input” refers to the time invested, financial expenditure, and administrative effort required for implementation. This is measured through metrics such as project timelines, budget allocation and inter-agency coordination levels.
- “Impact” captures the outcomes generated, including metrics such as changes in bilateral trade volumes, shifts in energy interdependence and digital infrastructure uptake, etc.

*Note: While the outcomes are generally assessed in terms of their alignment with India's strategic and economic objectives, implying a positive direction, it is important to note that 'impact' in this paper is interpreted through the lens of the authors' judgement, and may pertain to negative implications due to certain actions. Similarly, certain actions may be negative in nature, to incite compellence (ability to compel another state to act in accordance with ones will and goals) for the purpose of meeting stated and/ or revealed objectives. Given the subjectivity in establishing direct causal links between specific instruments and macro-level outcomes, the assessment combines available data with qualitative evaluation. Where attribution is uncertain, the paper adopts a conservative approach, drawing inferences based on the coherence between stated objectives and observable developments.*

The nature of projects in India's neighbourhood often embodies a set of structural challenges that complicate their successful execution. Firstly, many initiatives are time-intensive, with negotiations or execution timelines stretching over a decade. Secondly, they are frequently politically sensitive, encountering high domestic resistance within partner countries, which can delay or derail progress. For example, India and Japan were initially awarded the Colombo port project, but domestic labour unions and political groups opposed "foreign involvement,"<sup>86</sup> leading Sri Lanka to unilaterally withdraw in 2021, despite prior agreements.

Furthermore, these projects are typically logistically complex, requiring coordination across multiple agencies with overlapping jurisdictions, thereby increasing the risk of bureaucratic friction. For example, the Kaladan Multimodal Transport Project, intended to link India's northeast with Myanmar's Sittwe port and then by river and road to Mizoram, requires cross-border coordination between India's Ministry of External Affairs, Ministry of Shipping, Ministry of Road Transport, and Myanmar's local and central authorities.<sup>87</sup>

Despite substantial investments, many initiatives offer limited visibility and return on investment, as they often involve high financial and political inputs, but yield only modest economic or strategic payoffs, particularly in the short-to-medium terms.

	Low Impact	High Impact
High Input	<p><b>Overinvested Tools</b> High input but limited impact.</p> <p><b>Examples:</b></p> <ul style="list-style-type: none"> <li>- Kaladan Multimodal Project (Myanmar)</li> <li>- CEPA negotiations with Sri Lanka and Bangladesh (ongoing for years)</li> <li>- BBIN connectivity (slow implementation)</li> </ul>	<p><b>Strategic Wins</b> High input, high payoff tools. These are successful tools that India should continue with.</p> <p><b>Examples:</b></p> <ul style="list-style-type: none"> <li>- Digital Public Infrastructure export</li> <li>- Hydropower &amp; energy projects in Bhutan and Nepal</li> <li>- LoCs to Sri Lanka &amp; Bangladesh (where repayment is functioning)</li> </ul>
Low Input	<p><b>Low-Priority Tools</b> Low input, low impact. These tools need redesign before further investment.</p> <p><b>Examples:</b></p> <ul style="list-style-type: none"> <li>- Trade agreements with Myanmar (low trade volume)</li> <li>- Tourism MOUs without follow-through in the Maldives or Myanmar</li> </ul>	<p><b>Optimal Tools</b> Low input but already showing good results. These can be scaled up easily for bigger returns.</p> <p><b>Examples:</b></p> <ul style="list-style-type: none"> <li>- RuPay/UPI diplomatic branding</li> <li>- Currency swap with Sri Lanka during the financial crisis</li> <li>- Climate cooperation under ISA with the Maldives</li> </ul>

*Table 2: A 2x2 Framework Assessing the input required and the outcome for tools of economic diplomacy India deploys in its neighbourhood*

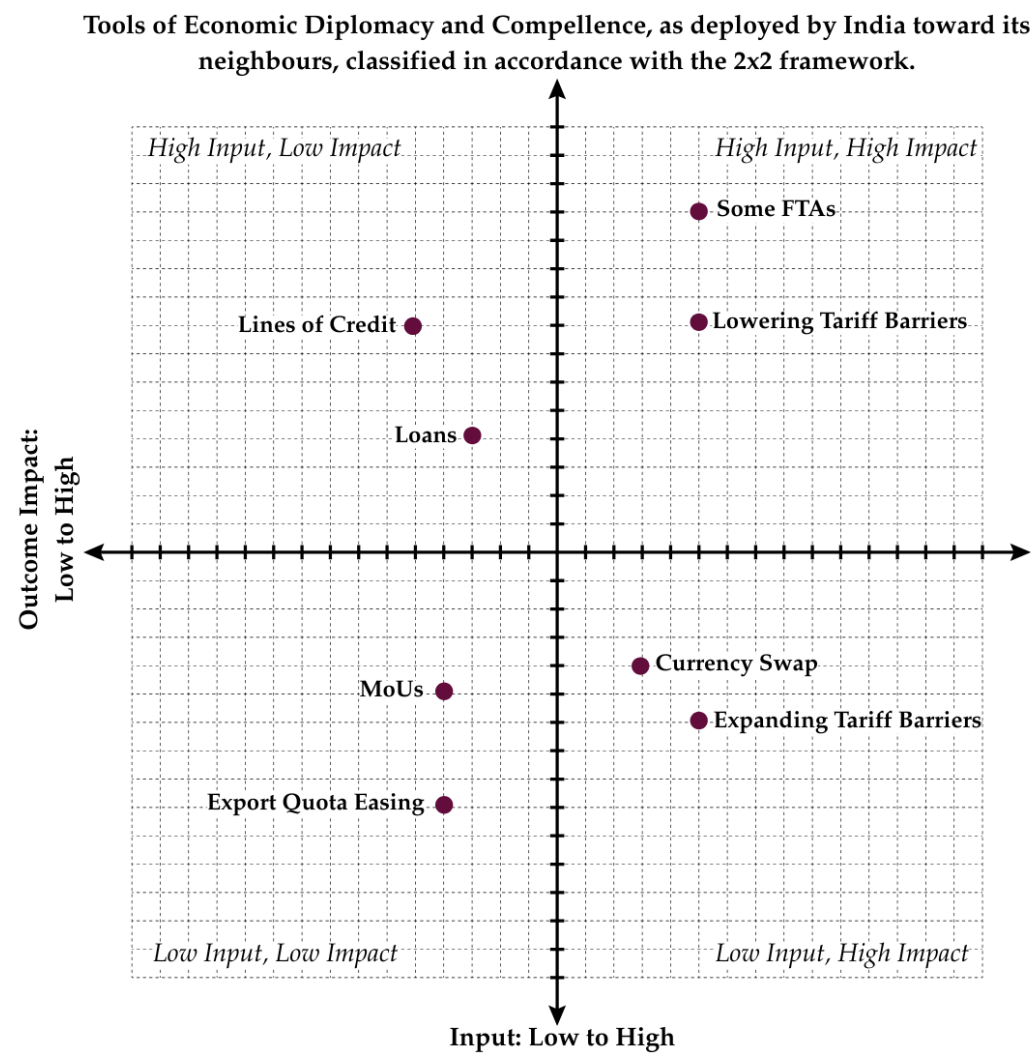
In this regard, based on the framework assessment, the paper suggests the following pathways to think through India's engagement with its neighbourhood going forward:

- Low-input tools require less diplomatic wrangling and lower-level political cooperation with partner countries. Sometimes, such cooperation can be at the G2G or B2B levels as well. Or, they can be tools requiring low domestic effort. In this regard, whether or not the impact of low-input tools is high or low, India must continue to invest in these tools in large numbers to gradually enhance the degree of interdependence between itself and the neighbouring economy.
  - However, India must consider redesigning low-input, low-impact tools to yield greater outcomes. An example is a trade agreement with Myanmar, which will not necessarily lead to greater trade between the two countries. In this regard, taking trade enhancement measures as a low-input tool, India could encourage business investment opportunities from Indian companies in Myanmar.
  - Even though the military rule in Myanmar, and the instability in areas like Rakhine makes them unsuitable for sustained operations, the SEZs in Yangon, Dawei, and Kyaukphyu can be leveraged by Indian businesses to export and even produce in Myanmar. For the Burmese government, receiving more investment should be a priority as well, and investment often can translate into enhanced trade favourability.

- With low-input, high-impact tools, India has the option to scale, but not without assessing whether they are likely to produce not only immediate outcomes but also sustained ones. For example, while the currency swap with Sri Lanka during the latter's economic crisis in 2022 cemented India's role as a first responder, governmental changes and sustained economic crises have not yielded sustainable results. To this end, soft loans aimed at sustaining economic momentum in partner countries may be a more fruitful tool.
- With high-input tools, it is vital to assess priority based on diplomatic, monetary, and political capital available. Sometimes, if a high-input tool can yield significant impact and sustained outcomes, it must be invested in and prioritised over multiple low-input, high-impact, or comforting-but-redundant high-input tools. In other words, India's neighbourhood policy may want to experiment with previously untouched measures to fulfil its objectives.
  - An example of such a high-input, high-impact tool could be the development of a free trading area between all of India's continental and maritime neighbours, excluding Pakistan and China. Another could be the deployment of India's digital public infrastructure in pilot zones across neighbours, with an aim to provide UPI as a digital good to partner countries. This would, of course, require the revamping of 'India Stack' based on each country's governmental requirements and ethical standards, but can open up vital economic opportunities in digital trade, both internally within countries and with India.

- High-input tools could often also include aspects of partnership that Indian domestic constituencies do not approve of, such as a closer partnership with the Muhammad Yunus government in Bangladesh, enhancing tourism to the Maldives, or settling the Kachchatheevu islet issue with Sri Lanka. However, the construct of the neighbourhood policy may have to take into account the realities of a complex neighbourhood, and balancing opportunities with power projection and narrative-peddling. Undermining already established partnerships to cater domestic audiences shall also enable neighbouring countries to hedge with and bet on China, which is something India does not want.
- Finally, there is another domestic component to high-input, high-impact tools – they can push internal reforms that enhance comprehensive national power. For example, in the face of growing dependence of the neighbourhood on Chinese defence systems, India requires a surge in defence spending to be able to produce at scale and subsequently export quality weapons systems. This export can have a two-fold result: countering, reliance on Chinese defence equipment to some degree, and expanding trade. Similarly, reforms in the Indian Foreign Services recruitment process may enable greater diplomatic representation across military, economic, agricultural, cultural, and social domains. This may especially include deployment of agricultural attachés in Bhutan and Nepal, which are largely agrarian economies.





*Table 3: Classification of Contemporary Toolkit*

Table 3 maps the toolkit on the 2x2 matrix, based on a subjective interpretation of input required and impact of the outcome of individual economic and economy-related tools. There are a few considerations, however:

- The tabular representation focuses on mapping the current realities of the input effort and outcomes / impact of tools by India in the context of its smaller neighbours.
- Financial tools such as loans and lines of credit have been placed in the ‘high-input, low-impact’ quadrant. However, it is possible that if loans are provided in an extreme case scenario where economic recovery can be made possible in a flailing situation (as in the case of Sri Lanka’s economic crisis in 2021-22), they can affect the nature of relations drastically, and for the better in the short-term. In the medium to long term, excessive debt and lack of repayment may create tensions, requiring great financial support for the neighbouring economies, and potentially leading them to borrow from external sources. Either way, there exist tentative scenarios where impact may be high.
- Erecting tariff Barriers, which may be a tool for compellence, are listed as ‘low-input, high-impact’ tools. This is so because India runs massive trade surpluses with most of its smaller neighbours. While erecting the barriers may be an easy affair, the impact may play out at a relatively larger scale, including social costs and political tensions, domestic protectionism, or even successful compellence.

To de-risk its regional projects from political fluctuations and enhance legitimacy, India must prioritise building local political and public buy-in. This entails systematically engaging a broad spectrum of stakeholders, including government officials, civil society organisations, and the media, to ensure that initiatives are perceived as collaborative rather than externally imposed.

Further, pooling financial and political resources with other like-minded countries would help distribute both risks and responsibilities, thereby increasing project resilience. For example, climate cooperation under the International Solar Alliance often involves co-financing with France, the World Bank, or private sector players, reducing India's financial burden while amplifying impact.

Long-term regional economic integration reduces vulnerabilities for India as well. By connecting Indian markets to Bangladesh's manufacturing hubs, Nepal's hydropower, Bhutan's energy resources, and Sri Lanka's logistics networks, India diversifies supply chains, opens new export markets, and strengthens its energy security. Even projects with initially low returns can build cumulative economic and strategic dividends over time.

## VI. Conclusion

A prerequisite for India's rise as a regional and global power is ensuring stability and constructive engagement within its immediate neighbourhood. The presence of fragile, politically unstable, or economically failing states in close proximity is not in India's interests. A rising power cannot afford vulnerability in its own backyard. Hence, economic engagement, besides being a development tool, is an investment that yields political dividends. Targeted economic partnerships generate local goodwill, create societal buy-in and create leverage within the decision-making processes of partner countries.

This document has argued that beyond the stated policy objectives, three strategic imperatives must guide India's neighbourhood engagement: the pursuit of regional stability through economic integration and partnerships for domestic growth, the consolidation of India as the preeminent regional power, and the cultivation of goodwill and reputation as instruments of influence.

India's economic diplomacy must be increasingly focused on creating equal partnerships rather than asserting dominance. Transparent policies and inclusive development projects ensure that neighbouring nations do not perceive India's initiatives as exploitative or coercive. The importance of people-to-people connections in India's neighbourhood strategy cannot be overstated. Strong interpersonal ties foster a sense of shared destiny, which is critical for achieving both strategic and economic goals.

Economic asymmetries only amplify the trust deficit in the region. India's disproportionate economic power compared to its neighbours often leads to fears of unequal trade relationships. For instance, Bangladeshi businesses fear being swamped by Indian goods under free trade agreements. The inability to build trust within the sub-continent has led to the increased role of external actors like China and the United States. While these partnerships provide immediate benefits, they often come with long-term strategic costs, further complicating regional dynamics.

Therefore, the future of India's economic diplomacy must be guided by prioritising development over identity politics, building and sustaining elite linkages, and recognising that people-to-people ties are enduring strategic assets. Finally, by consistently pursuing long-term strategic gains over narrow reciprocity, India can embed itself as an indispensable partner and leader in the region.

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