III. Demystifying CPEC

A. *A Conceptual Leap?*

A Pakistan Business Council representative argued that, "CPEC is primarily a geopolitical project. Economics have merely been added on to it".[36] But not all business leaders are as sceptical. Given the fragility of Pakistan's economy, some believe that CPEC could have a useful "demonstration effect, indicating to other investors that Pakistan is a safe and attractive destination for foreign direct investment".[37] The CEO of a major Karachi-based business conglomerate described CPEC as a "win-win" that will provide Pakistan "much-needed project financing lines to make up for its infrastructure shortages", and attract other countries' suppliers and financial institutions to do business in the country. A senior partner at a leading corporate services firm said that once Chinese industrial units were set up in Pakistan, instead of merely exporting raw materials, the country could export high-value products to China.[38]

Politicians across the political spectrum also are mostly supportive. The leader of the opposition in the Senate noted that CPEC could encourage the modernisation of manufacturing; Punjab's chief minister believed that CPEC would help create jobs.[39] In its annual credit analysis for Pakistan, Moody's Investors Service concluded that, if successfully implemented, CPEC could transform Pakistan's economy by stimulating local and foreign investment.[40]

Still, analysis of the economic promise and impact of CPEC – as well as its ability to support a broad set of economic goals and an Islamabad-devised integrated strategy to develop the economy – is hampered by the opacity of its formulation and rollout. Pakistan's Planning Commission reportedly presented China with a full menu of projects for financing, with little apparent consideration for how these would be best sequenced. The menu includes everything from investment in the power sector to road and rail infrastructure, industrial cooperation and agricultural development. A former Planning Commission head described it as a "kitchen sink approach".[41]

There has been little input from key stakeholders, whether parliament, chambers of commerce or civil society organisations.[42] A major daily noted: "The ambitious CPEC partnership has deepened doubts about the willingness of the Pakistani state

[36] Crisis Group interview, Karachi, December 2017.
[37] Arif Rafiq, "The China-Pakistan Economic Corridor: Barriers and Impact", U.S. Institute of Peace, 25 October 2017.
[38] Arif Habib, "Why CPEC is a no-brainer"; Shabbar Zaidi, "Reality versus myth". Texts of speeches in "CPEC 2018 Summit: Supplement", reprinted in *Dawn*, 22 May 2018.
[39] Punjab Chief Minister Shahbaz Sharif said, "Pakistan has a huge youth bulge that can benefit from opportunities coming this way thanks to CPEC. If not given opportunities, our youth will be pushed into a bloody revolution". Sherry Rehman, "CPEC: A momentum for prosperity", texts of speeches in "CPEC 2018 Summit", op. cit.
[40] "Moody's reaffirms Pakistan's rating, but vulnerabilities remain", *Dawn*, 22 May 2018.
[41] Crisis Group interview, Nadeem ul Haque, Lahore, November 2017.
[42] Crisis Group interviews, business leaders, chambers of commerce representatives, civil society activists, Lahore, Karachi and Islamabad, November 2017-January 2018.

to be transparent and its ability to negotiate the best possible economic terms in every deal".[43]

CPEC's Long-Term Plan (2017-2030), released in December 2017, defines the project broadly as "a growth axis and a development belt", with "the comprehensive transportation corridor and industrial cooperation between Pakistan and China as the main axis" and "concrete economic and trade cooperation" as "the engine". The plan names four priorities in Pakistan – the Gwadar port, energy, transport infrastructure and industrial cooperation, which would speed up Pakistan's industrialisation and urbanisation. According to CPEC's timelines, short-term projects would be completed by 2020; medium-term projects, including the industrial system, close to completion by 2025; and long-term projects in place by 2030.[44] Yet the plan provides barely any details on planned and proposed projects and agreements.

The seventh meeting of the CPEC Joint Coordination Committee, which reviews and approves CPEC projects, took place in November 2017. The committee's discussions reportedly suggest a potential shift from concessional loans for energy and infrastructure projects to commercially viable projects that would not qualify for concessional loans.[45] Since sovereign guarantees would likely apply to such commercial loans, it would further increase Pakistan's national debt. Yet detailed information is limited. A senior journalist investigating CPEC said, "we still know very little about CPEC. The material that would tell us more is still vigorously concealed".[46] Another analyst commented, "the launch of the detailed CPEC plan neither adds anything new to our understanding of the project nor helps remove the concerns of critics regarding the overall impact of the project".[47]

The government is largely responsible for this lack of transparency. But though individual parliamentarians have raised concerns about inequitable distribution of CPEC projects and resources, all the major opposition parties have also supported CPEC and been reluctant to discuss it in parliament. Committee chairs and ranking members have failed to promote open debate or exercise oversight over one of Pakistan's most ambitious economic and geostrategic undertakings.

B. *Power Production and Debt*

Islamabad has encouraged CPEC investment in power production, with power projects included in its first ("early harvest") phase.[48] To attract Chinese investment, most plants are being built with Chinese equipment and many will be Chinese-owned. More wattage for the national grid will certainly help reverse the decline in

[43] Editorial, "Balancing ties", *Dawn*, 7 March 2018.

[44] The belt, consisting of CPEC's "core zone", would include all four Pakistani provinces, the federal capital territory, Islamabad, and Gilgit-Baltistan, and Xinjiang in China. "Long-Term Plan for China-Pakistan Economic Corridor", op. cit. The Long-Term Plan's memorandum of understanding was signed on 21 November 2017. A major daily had published a leaked version of the Long-Term Plan in May 2017. "Exclusive: CPEC master plan revealed", *Dawn*, 15 May 2017.

[45] Crisis Group interview, Naheed Memon, chairperson, Sindh Board of Investment, Karachi, December 2017. Memon was part of the Sindh delegation to the Joint Cooperation Committee meeting.

[46] Crisis Group interview, Khurram Hussain, Karachi, December 2017.

[47] Mushtaq Rajpar, "CPEC concerns", *The News*, 21 December 2017.

[48] For example, in 2016 the Karot hydropower project was initiated as the first investment by China's Silk Road Fund. Ruan, "Belt and Road Initiative", op. cit.

economic productivity caused by long power outages. Yet the pace of implementation has been slow at best.[49] Moreover, International Monetary Fund (IMF) assessments show that Pakistan's repayment obligations, including the payment of debts and guaranteed rates of return on equity for investors (17 per cent for power projects), "will likely offset a significant share of these [foreign direct investment and other external funding] inflows, such that the current account deficit would widen". It warned, "Pakistan's capacity to repay could deteriorate at a faster pace, with faster depletion of foreign exchange reserves and significant implications for economic growth".[50]

These assessments reflect that in its bid to attract investment, Pakistan offers overly generous terms to foreign (including Chinese) investors. These will be unaffordable if the increased power generation does not yield the expected economic growth. If, and when, Islamabad seeks another IMF bailout, the IMF will likely demand greater transparency in CPEC energy and other projects' financing, so as to assess the impact of expensive Chinese loans on Pakistan's balance of payment crisis.[51]

The new plants are in any case inadequate since an aging and inefficient power infrastructure will remain unreformed. Domestic industries and consumers will also continue to pay more, because of a tariff policy that is overly generous to foreign investors and reflects rising expenditure on security for CPEC projects and personnel (discussed below).[52]

[49] The Planning Commission initially said CPEC's energy component would generate 17,000 megawatts by 2020, but the current pace suggests only half that output would be in place by then. Rafiq, "The China-Pakistan Economic Corridor", op. cit.

[50] In 2018, Pakistan's current account deficit will be around $16.6 billion; according to IMF estimates, its gross international reserves were $12.7 billion by mid-February 2018, while foreign exchange liabilities were $13,496 billion. Rejecting criticism that CPEC was a debt trap at the April 2018 CPEC summit, then Planning, Development and Reform Minister Ahsen Iqbal said, "out of the total package, an estimated amount of 34 billion [U.S. dollars are] in the form of investment by Chinese companies in the energy projects in Pakistan". According to a former Pakistani finance minister, if Pakistan has to return $100 billion in principal and interest over the next twenty years, it would amount to $4-5 billion annually. Abdul Hafiz Sheikh, "Is Pakistan ready to make the right choices?", text in CPEC 2018 Summit, op. cit. According to IMF, estimates of annual outflows for CPEC-related investment and government-to-government loans would reach $3.5 billion by 2024-2025. "IMF warns of looming CPEC bill", *Dawn*, 17 October 2016. "IMF projects gross external financing needs at $24.464 billion in FY2018", *The News*, 16 March 2018; Editorial, "IMF warning", *The News*, 12 March 2018; "Govt to secure $1,5bln commercial loan in April to shore up reserves", *The News*, 28 March 2018; "Sheer size of CPEC portfolio appals IMF", *The Express Tribune*, 13 December 2017; Ishrat Hussain, "Financing burden of CPEC", *Dawn*, 11 February 2017. Hussain is a former governor of Pakistan's State Bank.

[51] See "Pakistan needs IMF support, Mulk warned", *The Express Tribune*, 5 June 2018; and "Pakistan refutes IMF as it eyes bonds, China funding", Bloomberg, 8 March 2018.

[52] In August 2017, the National Electric Power Regulatory Authority allowed power producers to charge consumers 1 per cent of capital cost in nineteen CPEC power projects for 20-30 years, for the provision of security to Chinese personnel and projects. Jawad Syed, "Terrorising the Belt and Road: A Critical Analysis of Security Threats to Chinese Nationals and Businesses in Pakistan", working paper, Lahore University of Management Sciences, China-Pakistan Management Initiative, November 2017. "If energy input costs don't come down, we can't benefit", said a senior Pakistan Business Council representative. Crisis Group interview, Lahore, November 2017.

C. Special Economic Zones and Industrial Cooperation

Special Economic Zones (SEZs) and industrialisation are among the key areas of co-operation, and possibly the most critical for economic growth and job creation. Of several provincial economic zones Pakistan has proposed so far, China has agreed to first develop one each in Sindh, Khyber Pakhtunkhwa and Punjab. Work has already begun on the largest, the M3 industrial city in Punjab's Faisalabad district.[53]

Special economic zones were integral to China's 1980s economic reforms, subject to free-market and export-oriented policies and measures such as tax benefits and preferential treatment of foreign investment.[54] For CPEC, Pakistan's GSP+ access to the EU will likely attract Chinese investors and producers, as will tax rebates and other incentives.[55] If Pakistani producers and labour benefit, the zones, coupled with pro-export and growth reforms, could indeed create opportunities for Pakistan.

If not, they could undermine existing domestic industry. Information is scarce about how the zones will relate to the rest of the economy, which could slow other investments. For example, producers would be hesitant to establish factories or mills if a nearby CPEC zone produces similar goods but with the benefit of tax, duty and other concessions. An industrialist complained: "There's no mechanism for such information flows. If the Chinese plan to set up something that competes with me, I'll find out too late".[56] Whether these zones will ultimately produce products that can compete in the international market, including against Chinese manufactures is also debatable.

Much depends on Pakistan's regulatory framework, where there have been few changes to level the playing field. Pakistan's more than 60 industrial zones (unrelated to CPEC) have done little to increase industrial competitiveness, and the most prominent industries, such as textiles and automobile manufacturers, survive on subsidies and other forms of protection, with few incentives to be competitive. Pakistani policy is skewed toward imports, given a one-time 6 per cent import duty, rather than production. Manufacturing accounts for 13 per cent of the economy but almost 60 per cent of the tax burden.[57] "China is not contracted to make Pakistan more competi-

[53] The other provincial SEZs are Dhabeji Industrial Park in Thatta, Sindh, and Hattar Industrial Estate-II in Khyber Pakhtunkhwa. Other approved SEZs include one each in Azad Jammu and Kashmir (Mirpur), Gilgit-Baltistan (Moqpondass SEZ) and FATA's Mohmand agency (Mohmand Marble City). Islamabad is pushing for two federal SEZs, in Port Qasim, Karachi and in Islamabad (ICT Model Industrial Zone). "China to continue concessional financing under CPEC", *Dawn*, 22 May 2018; "Govt keen to launch Islamabad, Karachi SEZs this year", *Dawn*, 2 February 2018; "Due to delay, Centre plans to take over development of economic zones", *The Express Tribune*, 14 January 2018; "Three economic zones set to take off under CPEC", *The Express Tribune*, 13 November 2017.
[54] Frank Holmes, "China's new special economic zone evokes memories of Shenzhen", *Forbes*, 21 April 2017.
[55] The EU granted Pakistan GSP+ access to its markets in December 2013, including zero tariffs on 20 per cent of Pakistani products and preferential rates for 70 per cent.
[56] Crisis Group interviews, Lahore, December 2017. According to CPEC's Long-Term Plan, CPEC will "encourage various forms of Chinese enterprises to enter the Pakistani market". "Long-Term Plan for China-Pakistan Economic Corridor", op. cit.
[57] Statistics provided by Pakistan Business Council, Karachi, December 2017.

tive", said a senior Lahore Chamber of Commerce member. "We have to do that ourselves".[58]

[58] Crisis Group interview, Lahore, November 2017.