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## CPEC IN MOTION

### The Battle Begins

At first, given the history of economic relations between Pakistan and China, it was not apparent that real money was going to be at stake in CPEC. The old pattern had been one of grand announcements followed by tepid progress. Now, even though many of the Chinese financing institutions were still skeptical, the political decision in Beijing, particularly in the context of the Belt and Road Initiative, was to find ways to resolve problems, rather than using them as excuses to stop or slow down.<sup>1</sup> On the Pakistani side, while there were significant differences at the provincial level over the capacity and willingness to execute the projects, the ministries and provincial governments that pushed ahead found matching enthusiasm from their Chinese counterparts.

But China also had to deal with several waves of criticism from some players on the Pakistani side—some of it fair, some of it based on misconceptions. The general problem that it had to navigate in the first phase was that the PML-N had limited interest in bringing other political parties on board or sharing the credit: although ostensibly a national project, CPEC had a distinct party-political flavor to it. This ultimately affected the army's view of CPEC too, though that was further down the line.

In the short term, much of the criticism—voiced by groups ranging from the religious, rightist Jamiat Ulema-e Islam (F) party to the secular, leftist Awami National Party—focused on the fact that the supposed priority route of CPEC would pass through Punjab and various developed areas of Pakistan, rather than through a “western route” that would include Khyber-Pakhtunkhwa and Balochistan, where some of the other parties had their political bases.<sup>2</sup> The Pakistan Peoples Party was a clear exception: it had been on board with CPEC from the start and wanted to claim credit for its own role in getting the project moving.

Chinese officials were keen to stress that the spigots could be turned on for everyone. “Rather than fighting over their share of the pie, we can just make a bigger pie,” one told a Pakistani audience at a CPEC meeting in 2016.<sup>3</sup> Chinese officials repeatedly emphasized to their Pakistani interlocutors that CPEC would include an assortment of new infrastructure connections rather than a single “route.” But discontent continued to grow despite all-party conferences, meetings with Chinese representatives, and declarations of willingness to prioritize road construction in the west.

Perhaps the biggest problem for China was Imran Khan's Pakistan Tehreek-e-Insaf party. Any criticism was a shock to Beijing, which had been used to a situation where it was virtually untouchable in Pakistan. The PTI

1 Interviews Islamabad, Karachi, and Lahore, 2015-2019.

2 International Crisis Group, [China-Pakistan Economic Corridor: Opportunities and Risks](#), June 29, 2018.

3 The phrase was used by Chinese officials at a public event attended by the author in Islamabad, 2016.

was a rising political force with which it had not yet come to terms.<sup>4</sup> Khan's views on China were elusive, and the party had little of the history of strong ties with the country that the major parties had built over decades. With one or two exceptions, the PTI also lacked expertise on China, which meant that there were few intermediaries who could help navigate relations.

The issue for China was not just the public criticism about routes and unfair distribution of benefits, or the boycotting of all-party conferences, but the fact that the PTI ran one of the most critical provinces, Khyber-Pakhtunkhwa, where its jaundiced view of CPEC played out in the provincial government's approach to projects. Privately, Chinese officials complained that the PTI "didn't get it" and had failed to appreciate that resources could be marshaled for their political priorities too.<sup>5</sup> The Chinese embassy in Islamabad held meetings with Khan to try to allay the PTI's concerns, but it was ultimately moved to issue a rare public statement in July 2016 saying that political parties should "address their differences" in order to create "favorable conditions" for CPEC's completion.<sup>6</sup>

While much of the political infighting focused on the division of resources among different players in Pakistan, some raised concerns about the lack of transparency surrounding CPEC. Particularly in the early stages, as multiple projects were being negotiated and astronomical numbers were being thrown around by ministers, the opacity of the scheme started to become a concern not just for opposition parties and the wider public, but even within the government.

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The sharpest public criticism came from the governor of the central bank, Ashraf Mahmood Wathra. In December 2015, he declared that even he did not know what the debt implications of CPEC actually were. "I don't know out of the \$46 billion how much is debt, how much is equity and how much is in kind," he said.<sup>7</sup> There were estimates of CPEC's loan terms, the off-the-books obligations, the impact on the balance of payments situation, and other issues, but few authoritative numbers seemed to be available.

Concerns over the specifics of the project's financing were magnified by the fact that Pakistan had been negotiating with its back against the wall: it needed new sources of investment, and China was perhaps the only suitor willing to bring significant resources to the table. Beijing used that leverage to strike a hard bargain: it demanded, and received, a risk premium and high returns on equity, among other sweeteners. Despite the fact that it pursued CPEC with over-arching strategic goals in mind, its companies and financing institutions sought the best possible terms from Pakistan, which—while not exactly predatory—were far from concessional.<sup>8</sup>

4 Khawar Ghumman, "[Protests not against CPEC, PTI chief assures Chinese envoy](#)," Dawn, June 21, 2017.

5 Interviews, Islamabad, and Beijing, 2016-2017.

6 Khawar Ghumman, "[PML-N unwilling to share CPEC control?](#)" Dawn, July 18, 2016.

7 Katharine Houreld, "[Pakistan Should Be More Transparent on \\$46 bn China Deal, State Bank Head Says](#)," Reuters, December 4, 2015.

8 Interviews, Islamabad and Beijing, 2014-2019.



*CPEC coal-fired power plant at Port Qasim.*

Some on the Pakistani side were clear-eyed about the implications. One official who was closely involved in the negotiations contended at the time that, if there was a future debt problem, Pakistan would simply renegotiate terms at a later stage, given that China's strategic interests meant that it would not want the country to run into excessive economic difficulties.<sup>9</sup> The official was not necessarily wrong. One Chinese expert characterized the relatively tough initial terms as being a necessary discipline: "We can't be too generous up front. We need the Pakistanis to propose projects that make sense even in difficult economic conditions rather than just seeing us as a source of cheap finance," the official said. "But Pakistan is not a place where our main priority is to make money—if we have to revisit loans and contracts at a later point, we can do that."<sup>10</sup>

Others in Pakistan worried about what they were seeing elsewhere on the Belt and Road. In early 2015, the newly elected government in Sri Lanka was dealing uncomfortably with the financial aftermath of a series of "white elephant" projects in the south of the country.<sup>11</sup> The situation had considerable political resonance in Pakistan, despite the vast differences in the situation of the two countries and in their ties with China. When the Sri Lankan government signed over to China a ninety-nine-year lease on the strategic port of Hambantota as part of a debt-relief deal in 2017, those concerns intensified, given the echoes of colonial experiences past.

<sup>9</sup> Interviews, Islamabad, 2015.

<sup>10</sup> Interviews, Beijing and Washington, DC, 2016.

<sup>11</sup> Maria Abi-Habib, "[How China Got Sri Lanka to Cough Up a Port](#)," New York Times, June 25, 2018.

There was a notable spike of controversy about the CPEC long-term plan, especially after Dawn newspaper leaked the details of an expansive, 231-page planning document for it from the China Development Bank in July 2017 that seemed to herald a Chinese presence in virtually every sector of the economy, from the leasing of thousands of acres of agricultural land to surveillance systems in every major city. An editorial accompanying the leak argued that CPEC's "scope has no precedent in Pakistan's history in terms of how far it opens up the domestic economy to participation by foreign enterprises."<sup>12</sup> The final version of the long-term plan was a considerably slimmed-down indicative list of areas of cooperation, but the leaked version helped to create the impression that a dramatic scheme for the country was being covertly hatched.

Other concerns bubbled up in Pakistan's business community.<sup>13</sup> Many in the private sector had already been hit hard by the consequences of the 2006 free trade agreement with China—which saw a vast explosion of Chinese imports and little apparent matching benefit on the Pakistani side—and did not want to be burned again.

Some businesses were concerned that Chinese companies would be offered preferential terms that were not available to their Pakistani counterparts, such as duty-free imports and tax breaks. The focal point for these concerns was the proposed SEZs that were supposed to drive the second phase of CPEC.<sup>14</sup> China's pitch—that its own businesses had gone through the shock of SEZ-driven competition from foreign investors in the 1980s and 1990s and emerged stronger for it—was not altogether reassuring.<sup>15</sup>

There was also concern that CPEC would create a new "charmed circle" of Pakistani businesses—largely in Punjab—that would benefit from privileged relationships with Chinese companies, allowing them an inside track on procurement contracts and other deals, while other corporate interests languished.

As CPEC got underway, new problems began to emerge. At the local level across the country, there were rumors and anxieties about an influx of Chinese workers, about land being taken without compensation, and about improper dress and behavior by Chinese nationals. Given that perhaps the most serious crisis between the two countries in the previous decade—the kidnapping of Chinese "massage workers" and the subsequent siege of Lal Masjid in Islamabad in 2007—was prompted by precisely these sorts of social tensions, the two governments had to treat these concerns seriously, and the Chinese embassy embarked on an sustained effort to squash rumors on social media.<sup>16</sup>

Some cases went beyond rumors, including a widely circulated video showing Chinese workers attacking their Pakistani security detail after they were refused a visit to a brothel, and a major controversy about

12 Khurram Hussain, "[Exclusive: CPEC master plan revealed](#)," Dawn, June 21, 2017.

13 Nasir Jamal, "[Descon head wants level playing field under CPEC](#)," Dawn, January 8, 2018.

14 Michael Kovrig, "[National Ambitions Meet Local Opposition Along the China-Pakistan Economic Corridor](#)," The Diplomat, July 24, 2018.

15 Ibid.

16 The exemplar being the deputy chief of mission, Zhao Lijian, on twitter at @zlj517



Pakistani women being drawn into Chinese human-trafficking networks.<sup>17</sup> Chinese officials had to deal with an influx of their nationals, who were embroiled in everything from ATM skimming to proselytizing.<sup>18</sup> Incidents like these made clear that social tensions between Chinese guest workers and local populations were on the rise.

While Chinese workers operating under the CPEC security umbrella were amply protected, those outside it were still at considerable risk. A Chinese cyclist en route to Iran was kidnapped in Khyber Pakhtunkhwa province in May 2014; he was freed in August 2015. Other Chinese nationals were less lucky: two Christian missionaries in working Quetta were kidnapped in May 2017 and killed less than a month later. In February 2018, a COSCO executive was shot dead in his car in an affluent neighborhood of Karachi, in an apparent targeted attack.<sup>19</sup>

*Local-level tensions aside, there was genuine support among many in Pakistan for CPEC. China appeared to be coming through for the country just as it was running into deep trouble with its other outside sponsors.*

Local-level tensions aside, there was genuine support among many in Pakistan for CPEC. China appeared to be coming through for the country just as it was running into deep trouble with its other outside sponsors. There was also a sustained attempt by both sides to build a stronger level of elite, and even middle-class, involvement in the Sino-Pakistani relationship: the traffic between the two countries vastly increased, whether among officials, academics, businesspeople, students, or through other cultural exchanges. A mini-“China mania” of sorts took off in Pakistan.<sup>20</sup>

That said, given the scale and scope of CPEC, wide-ranging political consultation was needed in order to ensure broad-based political and social buy-in for the project. Instead, the debate over CPEC quickly took on a binary “for” or “against” quality. Any criticism was characterized as “malining” CPEC rather than scrutinizing it.<sup>21</sup> Many of the complaints were manageable and some of the early criticism was taken on board. But CPEC never came close to achieving the kind of deep-rooted consensus necessary to ensure that the projects and plans drawn up under its umbrella could proceed as intended across changes of government, changes of national mood, or changes in Pakistan’s economic circumstances. And all of these dimensions were about to take a sharp turn for the worse.

17 Priyamvada Grover, “Chinese workers in Pakistan got way too angry when stopped from visiting brothels,” The Print, April 6, 2018, and CBS News, “Pakistani officials claim women trafficked into prostitution in China after marriage,” June 17, 2019.

18 Imtiaz Ali, “4 Chinese nationals arrested in another ATM skimming incident in Karachi,” Dawn, January 14, 2018.

19 BBC News, “Abducted Chinese cyclist Hong Xudong released in Pakistan,” August 23, 2015; Kevin Ponniah et al, “Risky Road: China’s missionaries follow Beijing west,” BBC News, September 4, 2017; Syed Raza Hassan, “Senior Chinese shipping executive shot dead in Pakistan,” Reuters, February 5, 2018.

20 Nasir Jamal, “Mother China: A ‘Chinese revolution’ sweeps across Pakistan,” Herald, July 15, 2018.

21 China Daily, “China Daily Editorial: Is an evil design at play to malign the CPEC?” September 12, 2018.

## The view from New Delhi

“CPEC is intended to wean the populace from fundamentalism,” Li Keqiang to Narendra Modi<sup>1</sup>

Many external actors were cautiously supportive of CPEC in its early stages. The United States had been urging China for years to take on precisely this sort of role. European countries, the Gulf States, and even Japan—which was highly wary of the BRI—took a similar view. They and other countries were also curious about whether they might be involved commercially in Chinese-funded projects.

India was the clear exception. Its formal position on CPEC was that it was a sovereignty issue given that the “route” of the corridor traversed Gilgit-Baltistan, claimed by India as part of greater Kashmir.<sup>2</sup> In practice, there was very little by way of new projects in Gilgit-Baltistan, with most of the road upgrades that were rebranded as part of CPEC having been set in motion long before 2015.<sup>3</sup> In negotiating the plan for CPEC with their Pakistani counterparts, the Chinese side were cautious not to include any large-scale projects in Gilgit-Baltistan that might represent a clear, material change to the status quo—indeed, there were local complaints about precisely this fact. At the same time, India had not historically taken the position that smaller-scale economic investments in Kashmir were a priori objectionable and a sovereignty violation.<sup>4</sup>

The vehemence of India’s objections to CPEC was therefore something of a surprise to China: Prime Minister Narendra Modi would bring the issue up directly in his bilateral meetings with Xi Jinping and with other non-Chinese counterparts. It was also used as grounds for India to refuse to participate in the first Belt and Road Forum in 2017, to China’s considerable chagrin. At the peak of India’s opposition, Modi’s Independence Day speech of 2016 referenced Balochistan explicitly, seemingly hinting that the country might expand its support to Baloch insurgents in targeting Chinese economic assets.<sup>5</sup>

While sovereignty was the stated objection, India had several other concerns that were less vocally expressed. New Delhi’s relationship with China had been deteriorating sharply prior to 2015, and CPEC looked like a corollary upgrade in Sino-Pakistani ties, which India had—not without basis—seen for decades as being directed at them. The history of economic relations between China and Pakistan also strongly suggested that CPEC would take on a military-security quality rather than being purely economic, with Gwadar port one of the obvious focal points.

China tried to argue that CPEC would actually be beneficial to India too: it would help to stabilize and induce restraint in Pakistan, and reduce incentives for extremism. But India was inclined to see CPEC

1 Shishir Gupta, “Govt makes it clear: India has not forgotten Pakistan-occupied Kashmir,” *Hindustan Times*, May 24, 2015.

2 *The Economic Times*, “CPEC violates sovereignty: India tells China,” July 12, 2018.

3 Adam Hodge, “Karakoram Highway: China’s treacherous Pakistan corridor,” *The Diplomat*, July 30, 2013.

4 USAID, *Mangla Dam Rehabilitation Project*, March 14, 2016.

5 *Times of India*, “Chinese Scholars ‘Deeply Disturbed’ by PM Modi’s Reference to Balochistan,” August 28, 2016.



*Khunjerab Pass, at the China-Pakistan border. CPEC road projects pass through territory claimed by India.*

as more likely to embolden its neighbor, and even to create the risk that future Indo-Pakistani conflicts might actually draw in China as well. These concerns were bolstered by the attacks by Kashmiri militants on Pathankot Air Force Station in India's northern Punjab state in January 2016 and on an Indian military outpost in Uri in Kashmir in September that year, which seemed to imply renewed threats of cross-border militancy following CPEC's launch.

It was also hard to separate CPEC from other dimensions in which India saw the upgraded Sino-Pakistani relationship as having negative repercussions. In June 2016, for example, China blocked it from joining the Nuclear Suppliers Group, partly at Pakistan's behest.<sup>6</sup> In 2016 and 2017, China also blocked efforts by the U.N. Security Council's "1267 Committee" (which is concerned with the sanctions regime against Islamist militants) from taking action against a key Pakistani-based militant leader, Masood Azhar, who has been behind some of the most prominent attacks on Indian soil.<sup>7</sup>

India's opposition to CPEC had ramifications on a few fronts. It made it difficult for the country's partners to publicly support the effort or to play an active commercial role in projects. It also deepened the "with us or against us" quality to the CPEC debate in Pakistan itself. And it created a real headache for China, which seemed to have believed that, while its diplomatic support and its security ties with Pakistan would create tensions with India, its expanded commercial and economic role might be viewed more neutrally by Delhi. Instead, CPEC turned out to be yet another item on a lengthening list of disputes between India and China that came to a head in 2017.

<sup>6</sup> James Pearson, "[China rejects bending rule for India to join nuclear club](#)," Reuters, June 24, 2016.

<sup>7</sup> In May 2019, Beijing changed course, and allowed militant leader Masood Azhar to be added to the sanctions blacklist maintained by the 1267 Committee. Associated Press, "U.N. Adds Leader of Outlawed Pakistan Group to Sanctions List," May 1, 2019.



## Dark Clouds Gather

Despite the political infighting and criticism in Pakistan, the first two years of CPEC saw many successes. The value of projects under negotiation expanded from the original \$46 billion to \$62 billion, with new hydroelectric power projects added to the mix.<sup>22</sup> More importantly, the value of projects that were signed off and moved into implementation hit \$19 billion.

The speed in some of these cases was genuinely impressive: the Sahiwal coal-power project and the first unit of the Port Qasim coal-power project were completed well ahead of schedule, adding 2,600 MW to Pakistan's national grid. Sahiwal, in Punjab, set a record for the construction speed of a unit of this kind, clocking in at 200 days ahead of the planned completion date.<sup>23</sup> Other power projects fared less well: the Gadani coal-power project, for example, was dropped from CPEC, and a major solar-power project went into stasis.<sup>24</sup>

Progress on the Gwadar port projects was considerably slower, due to a combination of bureaucratic capacity in Balochistan and the scale of the task required to make it logistically functional, but it was at least physically connected to the province's interior, enabling a first symbolic convoy to be sent there all the way from Xinjiang in November 2016.<sup>25</sup> Still, going into the second half of the year, there was considerable momentum behind CPEC, with even the initially reluctant PTI chief minister of Khyber Pakhtunkhwa ultimately getting on board.

Yet there were dark clouds gathering on a number of fronts. The first set of issues related to the intended second phase of CPEC. The first phase imposed burdens on the Pakistani economy: the import of Chinese equipment hit the balance of payments, and, with the exception of laborers on road projects, there was no large-scale job generation associated with the investments. The promise of the second phase—industrial cooperation and the relocation of Chinese firms into special economic zones—was employment and exports, which would address both these issues. Yet objections from the business community and problems of land acquisition meant that the dozens of SEZs that had been planned were eventually pared down to a handful. Even these were either adjuncts to existing zones or made very slow progress.<sup>26</sup> And, unlike with the power projects that formed the core of the first phase, there was no major political push to overcome these problems.<sup>27</sup>

Many of the other CPEC infrastructure projects outside the energy sector were also moving at a notably slower pace. This was partly a reflection of the fact that, unlike the power projects, where all the up-front financing came from the Chinese side, the roads and railway lines that were a part of CPEC required consid-

22 Salman Siddiqui, "CPEC investment pushed from \$55b to \$62b," Express Tribune, April 12, 2017.

23 IEA Clean Coal Center, "Pakistan: Sahiwal coal power plant fully meets world standards," September 18, 2018.

24 Arif Rafiq, "The China Pakistan Economic Corridor: Barriers and Impact," United States Institute of Peace, October 2017.

25 Muhammad Zafar, "First Chinese Trade Convoy Arrives in Gwadar through CPEC," Express Tribune, November 12, 2016.

26 Jeremy Page and Saeed Shah, "China's global building spree runs into trouble in Pakistan," Wall Street Journal, July 22, 2018.

27 Shahbaz Rana, "Delay: SEZs unlikely to be ready for investment for two more years," Express Tribune, January 19, 2019.



*CPEC's Orange Line metro project, Lahore.*

erable financial outlays from the Pakistani government. By late 2017, as the economy started to slow down, it was less and less clear whether it would have the capacity to fund them.<sup>28</sup>

There were even more serious problems than the deteriorating economy. The rising tensions between Nawaz Sharif and the army finally boiled over. The Supreme Court ousted him from office over a corruption case in July 2017 and it became increasingly clear that the army intended to prevent Sharif from returning to the political frontlines.<sup>29</sup>

China had been counting on continuity. While the PML-N was far from perfect and CPEC evidently had its challenges, for Chinese purposes the party had largely been an effective partner in pushing the initiative forward. Although Beijing nominally stood above Pakistan's party politics, it was widely understood that it favored a second term for Sharif and would see it as no bad thing if he won an election by pointing to the successful economic partnership with China.<sup>30</sup>

28 Khurram Hussain, "[The year of Dar's reckoning](#)," Dawn, December 28, 2017. Even by June 2017, the IMF was warning of "re-emerging vulnerabilities" in the Pakistani economy. Economist, "[Pakistan's old economic vulnerabilities persist](#)," June 29, 2017.

29 M. Ilyas Khan, "[A war of nerves between Pakistan's military and Sharif](#)," BBC News, May 28, 2018.

30 Interviews in Islamabad, Beijing, and Washington, DC, 2016-2018.

But by late 2017 it was deeply uncertain whether the army would allow the PML-N to fully and fairly participate in the next election, even without Sharif as prime minister.<sup>31</sup> China was already reluctant to agree to new projects with a government that was starting to face economic headwinds. As political uncertainty continued to grow in 2017, it adopted a wait-and-see attitude, wanting to have clarity on what new political constellation would emerge.

A change of government would expose China to a number of risks. It would have to deal with new people in key positions, a prospect it disliked so much that it had even lobbied for the planning minister, Ahsan Iqbal, to regain this job after he was reshuffled into another role. There was the potential for contracts to be reviewed or renegotiated by a new administration. Inevitably, there would be new political priorities to deal with and new payoffs to make. And even worse than low-level corruption would be any effort by a government to root it out and potentially expose the Chinese firms involved.

The army's problems with the prime minister colored its views of CPEC. There was clear disquiet about the fact that they did not feel they had adequate oversight of what was going on between the Chinese side and the Sharif brothers, including what money was changing hands.<sup>32</sup> Moreover, the army's concerns about CPEC were not limited to its identification with their chief political antagonist. Many in the army saw the need to respond to the bubbling discontent about China's growing economic presence in the country. Some worried that public resentment of the widening Chinese economic footprint, if allowed to fester, might start to chip away at the broad public support for the all-important security relationship.<sup>33</sup>

*Many in the army saw the need to respond to the bubbling discontent about China's growing economic presence in the country.*

Senior military officials also started to worry about the geopolitical implications of CPEC. However close the military relationship with China, it was not clear that the level of dependency that a maximalist version of CPEC implied was beneficial for the military or for Pakistan as a whole. Excessive reliance on China would reduce room for maneuver with other partners, including the United States. And far from CPEC tightening the two sides' bonds, it appeared to mean that Pakistan was starting to be taken for granted, as Chinese dealings with India would soon illustrate.

For its part, China was perfectly amenable to greater military involvement in CPEC; it had, after all, even pushed for a more formal role for the army in the decision-making over projects. But the speed with which the military moved against the Sharifs in 2017 caught Beijing off guard. Chinese officials in charge of CPEC had been banking on two terms for the PML-N government, and the army's decision to take down the prime minister effectively undercut their political strategy. According to some accounts, China conveyed its concerns to the army quite clearly.<sup>34</sup>

31 Maria Abi-Habib and Salman Masood, "Military's influence casts a shadow over Pakistan's election," New York Times, July 21, 2018.

32 Author interviews, Pakistan 2016-2019. For context, see Syeda Mamoon Rubab, "CPEC & the Army: Red flag," The Friday Times, September 2, 2016.

33 Author interviews, Pakistan 2016-2019.

34 Author interviews, Pakistan, 2019-2020.





*Pakistani workers on their way to work in the morning at a Chinese installation along the Karakoram Highway.*

At the same time that the political turmoil in Pakistan deepened, China was wrestling with the need to improve ties with India. Between 2015 and late 2017, the development of CPEC and the worsening Sino-Indian tensions continued along parallel—and occasionally overlapping—tracks. Then, from June to August 2017, China and India found themselves entangled in one of the most serious border incidents in decades, on the Doklam plateau on the China-Bhutan border. The crisis was triggered when Indian troops moved in to block a Chinese road-building effort in territory disputed by China and Bhutan. The next two months saw a military standoff at a juncture of high political significance for Beijing, given its proximity to a sensitive Communist Party Congress meeting.

With Xi seeking to consolidate his long-term control of the Chinese Communist Party, a major, unexpected flare-up on China's western borders was a serious problem and potential embarrassment. Militarily, strategically, and politically, the situation was perceived in China to be partly the product of misjudgments that raised serious questions about its overall approach to the region.<sup>35</sup> The tentative efforts at “de-hyphenation”—leaning closer to Pakistan without any concomitant effort to be responsive to India's sensitivities—started to look less wise in light of the Doklam standoff.

At the same time, China's broader geostrategic environment was also becoming increasingly difficult as the Trump administration embarked on a far more explicitly competitive approach to the Sino-U.S. relationship.

<sup>35</sup> Author interviews, Beijing, December 2018.



India became one of the focal points for China as it worked to calm its relations with other major powers while ties with the United States frayed.<sup>36</sup>

The public attempt by China and India to arrest the slide and draw a line under Doklam was the Xi-Modi summit in Wuhan in April 2018. At that meeting, the two countries committed to stabilizing their relationship and managing their emerging competition in a more predictable fashion.<sup>37</sup> One of the most obvious ways to bring this about was for China quietly to walk away from “de-hyphenation.” Instead, it would put elements of its relationship with Pakistan back on the negotiating table with India.

China took initial steps in this regard even before the Wuhan summit: in February 2018, for example, it reached a deal with India on Pakistan at a key meeting of the Financial Action Task Force (FATF), the inter-governmental organization that—among other responsibilities—coordinates state efforts against the funding of transnational militant groups. In return for India’s support for the Chinese candidate, Liu Xiangmin, for the FATF presidency, China would no longer try to block Pakistan’s being placed on the “grey list” for failing to curb terrorist financing.<sup>38</sup> This was ultimately followed in May 2019 by China’s decision to allow the U.N. Security Council’s 1267 Committee to place the Pakistan-based militant leader Masood Azhar on its sanctions list.

Chinese officials were at times candid about the need for the adjustment. As one former Chinese diplomat put it: “In the past, we mainly took Pakistan’s attitude into consideration, but now we need to balance Pakistan’s relationship with India and the rest of the international community.”<sup>39</sup> Just a few years after CPEC was launched, China was altering its overall approach to South Asia in important ways: strategically, economically, and politically, it was now hedging its bets.

At the same time, events in Pakistan made clear that CPEC was undergoing a serious revision. A symbolic turning point was the November 2017 Joint Coordination Commission (JCC) meeting in Islamabad. The JCC meetings, which had been running since August 2013 on an annual or biannual basis, were the most senior-level CPEC planning meetings between the two sides.

Prior to 2017, the JCC meetings had generally ended with a flurry of announcements and news stories about railway upgrades, new power plants, and road-construction projects. This meeting, however, amounted to a cold shower. Although the slimmed-down version of the long-term plan was signed off and there was a further half-hearted attempt to push forward on special economic zones, the main stories that emerged were about the projects that were not agreed to, rather than the ones that moved forward.<sup>40</sup>

36 Evan S. Medeiros, “China Reacts: Assessing Beijing’s response to Trump’s new China strategy,” China Leadership Monitor, March 1, 2019.

37 Tanvi Madan, “Dancing with the dragon? Deciphering India’s ‘China reset,’” War on the Rocks, April 26, 2018.

38 Smita Sharma, “US wanted Japan for FATF slot, India backed Beijing,” The Tribune, March 4, 2018.

39 Sarah Zheng, “Why China dropped its opposition to UN blacklisting of Pakistan-based terror chief Masood Azhar,” South China Morning Post, May 2, 2019.

40 Shahbaz Rana, “Pakistan stops bid to include Diamer-Bhasha Dam in CPEC,” Express Tribune, November 15, 2017.

There were good reasons for both sides to hold back on projects such as the enormous Diamer-Bhasha dam.<sup>41</sup> On the Chinese side, there were unanswered questions about its viability and concerns about how such a large investment in Gilgit-Baltistan would affect China's ability to claim to India that CPEC projects would not change the status quo in greater Kashmir. On the Pakistani side, there was no longer the same willingness to accept the kind of contractual terms that it agreed in the earlier, more desperate days of CPEC negotiations.

*By early 2018, CPEC had effectively gone into hiatus.*

But what was significant about the November 2017 JCC meeting was not any of the specific investments. Rather, it was that less than three years after the launch of CPEC, the overall plan had been scaled back considerably. The lead-up to the meeting was the last point at which the full array of CPEC projects—to which the \$62 billion figure was tied—was still in some sense under negotiation. From that point on—until 2020—the \$19 billion figure became the operative number.

By early 2018, CPEC had effectively gone into hiatus. Existing projects were still being completed, but as the election season began in earnest in Pakistan, and the country's economic troubles began to turn into a full-fledged crisis, there would be no new CPEC projects. Instead, China found itself playing a new role that it had previously sought to avoid: that of lender of last resort. It had traditionally been uncomfortable providing financing to alleviate Pakistan's current-account problems. But in early 2018, not least given the contributory role that CPEC had played, Beijing stepped in with short-term loans from the Chinese state and from large Chinese commercial banks.<sup>42</sup>

Chinese companies were already finding out that the supposed "high returns on equity" were proving elusive in practice. With the first power projects completed, they experienced Pakistan's circular debt problem at first hand. Chinese officials complained about the payment shortfalls on key energy projects and asking the Pakistani government to pay the difference. But given the country's weakening fiscal situation, this was impossible.

The chairman of one of the Chinese investing companies later gave public statements about revenue shortfalls at the Port Qasim power project, telling the Express Tribune:

We have around \$150 million (over Rs21 billion) late payments now...The delayed payment of tariff is a big issue for us every day...We are trying our best to generate more power and get more tariff payment timely as you know that this is a power plant, we have to import coal from the international market, also we have to repay debt to the financing banks...To be frank, the devaluation against the dollar...has caused us a lot of losses."<sup>43</sup>

As the elections began, the mood music around CPEC was growing very gloomy indeed.

<sup>41</sup> Ibid.

<sup>42</sup> Drazen Jorgic, "Exclusive: Pakistan seeks economic lifeline with fresh China loans," Reuters, May 25, 2018.

<sup>43</sup> Salman Siddiqui, "CPEC's first power project mired in financial difficulties," Express Tribune, May 10, 2019.