

## CPEC- Economic Revolution or Hype

*By Ashutosh MALIK*

The China-Pakistan Economic Corridor (CPEC), a massive \$55 billion bilateral developmental project between Pakistan and China, is supposed to be a “game changer” in the geopolitics and economics of South Asia. This economic corridor aims to connect Kashgar in the northwestern Chinese province of Xinjiang with Pakistan’s Gwadar port in Balochistan through a vast and complex network of roads measuring 3,000 km as well as other infrastructure projects. On paper the CPEC, intended to be completed by 2030, is a win-win for both countries. China will save millions of dollars every year by shortening its route for energy imports from the Middle East by about 12,000 km and also gets greater access to the Indian Ocean. On the other hand, Pakistan expects infrastructural enhancement and the reduction, or even elimination, of its severe energy crisis by getting in return an estimated \$34 billion for various hydro, solar, thermal, and wind-driven power plants. The interests of China in Pakistan are not just economically driven. There also lay geo-strategic interests. For instance, Gwadar port not only provides China with lucrative commercial benefits but also huge strategic and geopolitical advantages. Although at present Gwadar is being developed for commercial purposes only, there are huge chances for it to develop into a well-equipped military naval base in the future, which would provide China an enor-



mous strategic advantage in the region. On the other hand Pakistan, which is currently suffering from the worst kind of extremism, terrorism, and rampant corruption, intends to benefit economically from the project and thereby improve its world image under the patronage of China.

### **China’s interest in CPEC**

China-Pakistan Economic Corridor is planned as the alternative route to the Indian Ocean. In fact, a land route has been a new version of the ancient Silk Route. President Xi Jinping has embarked upon this project as one of his ambitious attempts to leave a lasting legacy. The CPEC deal grants the Chinese 40-year operation rights to the Gwadar port. This is hugely significant for Beijing because it will allow China to ship some of its oil coming from the Persian Gulf to that port and pump it through the pipelines to western China. Accordingly, with a transport route some 6,000 miles shorter, China will be able to save billions in transport costs and saved time. The development of Gwadar holds a

strategic importance to China as it enables Beijing a firm and reliable long term gateway in the Indian Ocean, effectively making it “two ocean power”. Indeed, Pakistan in general and Gwadar in particular will be playing a critical role in China’s joint plans for a Silk Road Economic Belt and a Maritime Silk Road linking China to Europe and beyond. CPEC furthermore provides China an alternative route to its regular route through the Malacca Straits, where the political temperature has risen recently.

In addition to economical importance, Gwadar port can be an important asset for Chinese navy. China’s first official defense White Paper, published in early 2015, which makes quite clear that the “traditional mentality that land outweighs sea must be abandoned, and great importance has to be attached to managing the seas and oceans and protecting maritime rights and interests.” The development of Gwadar into Chinese navy facility would without any doubt exponentially increase Sino-Indian maritime competition in the Indian Ocean.

The CPEC is an international extension of China’s effort to deliver security through economic development. Beijing has sought to clamp down on Xinjiang’s ethnic Uighur community and has met political violence with an expanded security presence and push for economic development schemes. These efforts implicate Pakistan because Uighur militant groups, like the East Turkestan Islamic Movement (ETIM) have sought refuge in the Pakistan-Afghanistan border areas, where they have established links with al-Qaeda and the Taliban in Afghanistan and Pakistan. China perceives the ETIM as a persistent threat, committed to targeting China and attacking Chinese interests inside Pakistan.

In this context, China plans to hamper down anti-state activity through economic development. By tackling the threat of jihadi organizations in neighboring Pakistan, China hopes to better secure its own territory.

### **Pakistan’s interest in CPEC**

Pakistan is the 25th largest economy in the world in terms of PPP and 44th in nominal terms. However, in recent years the country has faced stark economic challenges. Pakistan’s current account deficit widened 121% during the first eight months (July-February) of the ongoing fiscal year, standing at \$5.473 billion compared to \$2.482 billion in the same period of 2015. As a percentage of gross domestic product, the current account deficit rose to 2.6% in the first eight months of 2016-17 as opposed to 1.3% in the same period of last year. During the same eight-month period, the value of Pakistan exported goods also went down. The value was \$14.05 billion compared to exports valuing \$14.34 billion in the comparable period of 2015-16, reflecting a year-on-year decrease of 2%. Moreover, According to the Board of Investment, Pakistan received a record high FDI of \$5.4 billion in fiscal year 2008, however since then the country is struggling to touch even half of the milestone. In February 2017, FDI decreased 21% to \$123 million compared with the same month of previous year when it amounted to \$155 million. Cumulative FDI increased 6% to \$1.285 billion in the first eight months of the ongoing fiscal year, compared with \$1.212 billion in the same period of previous year<sup>4</sup>. Chinese investment through CPEC comes during the time when most of other countries are being wary of investing in Pakistan and hence comes as a huge respite for Pakistan’s Economy. A major part of investment comes in

form of Foreign Direct Investment. The amount of FDI to be invested through CPEC will amount larger than the cumulative FDI of last 40 years in Pakistan's economy. Through larger FDI, Pakistan expects to boost its GDP and eventually its present economic standing.

Pakistan consider CPEC to be a futuristic economic dimension in the 21st century<sup>5</sup> through which it can diminish its chronic shortage of energy and develop its crumbling structure which eats away almost 2 percentage of its GDP annually<sup>6</sup>. Pakistan is experiencing an acute energy crisis. Partly due to chronic losses and underinvestment, electricity supply from utilities is well short of demand. The deficit has exceeded 7,000 megawatts (MW), or about one-third of peak demand, during extreme periods.<sup>7</sup> one of the major factor of current power shortfall is the lack of investment in electricity generation and distribution. However, now the investment through CPEC has increased the optimism of Pakistan government to tackle its energy crisis. About 60 percent of \$55 billion funding is committed towards establishing energy and power projects in Pakistan. These projects will alleviate the country's chronic energy crisis which will further boost country's industrial and economic activities.

### **Financing of CPEC**

The total committed amount under CPEC has increased to \$55 billion. It is divided into two broad categories: \$35bn is allocated for energy projects while \$20bn is for agriculture, infrastructure, Gwadar development, industrial zones and mass transit schemes. The entire sum is to be invested till year 2030. Therefore, the implementation schedule would determine the payments stream. Most of major energy projects are

termed under early harvest scheme i.e. they need to be completed by 2018. Overall, energy projects are planned for completion by 2020, minus the usual bureaucratic delays. Under the early harvest program, 10,000 MW would be added to the national grid by 2018. The total investment under early harvest scheme is \$28bn. Infrastructure projects such as roads, highways, and port and airport development, amounting to \$10bn, can reasonably be expected to be concluded by 2025, while the remaining projects worth \$ 10bn would spill from 2025-30.

Through the above picture, it is possible to prepare a broad estimate of the financial obligation of Pakistan in coming years. The analysis can further be improved as the details of each project become available. The financing of CPEC will be done through Foreign Direct investment and governmental loans against 2 percent interest rate. The funding of energy industry is and will be undertaken through in the IPP (Independent Power Producer) mode —as applied to all private power producers in the country. The investment in entire energy portfolio will come through foreign investors under foreign direct investment. The investment through FDI's are generally guaranteed a 17pc to 20pc rate of return in dollar terms on their ownership (equity). However, "these investment loans would be taken by Chinese companies, mainly from the China Development Bank and China Exim Bank, against their own balance sheets. They would service the debt from their own earnings without any obligation on the part of the Pakistani government". Equipment and services for the projects will be imported from china and the corresponding financing of items will be through FDI received by Chinese firms. To which, again, there will be no obligation of return pay-

ments by Pakistani government. Moreover, to a certain extent, local equipment and services is being or will be used in project. Doing so, helps freeing a portion of FDI, which can be further used for repayments. For example, a highly extreme estimate is that only one-fourth of the total project cost would be spent locally and “the country would benefit from an inflow of \$9bn over an eight-year period, supplying the aggregate FDI by more than \$1bn annually”. This can be either utilized to decrease current account deficit or reduce external borrowing. The outflow of payments, rising from guaranteed 17pc rate of return, are estimated to be amount to \$2.4bn annually (derived from 60-40 debt and equity ratio).

The other portion of CPEC, i.e. infrastructure, is to be financed through government-to-government loans. The amount of loan is estimated to be \$15bn. As proclaimed, these loans will come with 2pc interest rate to be repaid over a 20- to 25-year period. It’s important to note that this amount’s debt servicing would be the Pakistan government’s obligation. “Debt-servicing payments would rise by \$910 million annually on account of CPEC loans (assuming a 20-year tenor)”. Assuming these calculations to be true, the amount burden on the external account will be around \$3.5bn annually. In order to finance this debt, Pakistan needs to find the extra non-debt-creating resources of \$3.5bn to offset this additional burden. Major economists involved in CPEC have found out that this can be possible only if the export grow by 14pc in dollar value. This is not unprecedented as Pakistan has previously recorded this growth rate<sup>10</sup>. Further, the substitution of imported fuels with domestic ones such as hydro, coal, wind and solar should be able to result in savings of at least \$1bn annu-

ally. These measures will need concerted action.

Financing of CPEC will be a challenge for Pakistan. In order to generate big revenue, She have to undergo major policy reforms such as revising tax laws, free trade agreement and reducing transaction cost. Above all, the priority of state should be establishing and empowering local industries through joint venture with Chinese enterprises. Also, developing skill labor force through training programs who can take over jobs from Chinese manpower. However, it can be inferred from the project map of CPEC that Pakistan is least focused in pursuing both.

### **Concerns regarding CPEC**

The economic miracle, CPEC could provide important benefits to Pakistan’s economy. The economic growth from project can pave essential path to region’s political stability. With much optimism, therefore, the project is considered a welcome development and encouraged by international community. However, the project raise concerns in India and other neighboring countries; who are worried about growing assertiveness of china in the region. New Delhi is skeptical about Chinese economic miracle for Pakistan and worried about Beijing’s ambition in South Asia. The fact that has further invited India’s irked is that the route passes through the disputed region of Kashmir. India blames that CPEC for undermining its sovereignty and regional integrity of country. New Delhi sees Gwadar port as part of China’s “String of Pearls” bases that extends from its eastern coast to the Arabian Sea. China is also developing ports in Sri Lanka and Bangladesh that are considered a potential military challenge to India. The Gwadar port, overlooking one of the world’s busiest shipping lanes in the Arabian Sea, has been leased to Beijing

for 40 years. New Delhi fears that the port might become a Chinese naval outpost, thereby threatening India's energy and economic security, as more than two thirds of India's petroleum imports pass through the area<sup>11</sup>.

However, China refutes every claim of CPEC having a political or military up-tone and terms it as sole economic cooperation. Moreover, China, at many instances, asserted that CPEC is open for corporation with India and with the involvement of India and neighboring countries, the vision of CPEC will be further encouraged. As insisted, this regional cooperation will lead to overall economic prosperity. However, India is very unlikely to get board on CPEC.

### **Conclusion**

Conventional wisdom in economics has individuals using reason to objectively weigh the costs and benefits of an option and then choosing it if benefits exceed costs. However, more and more evidence on actual behavior of human suggests that individuals start with their minds already made up and then pick and choose arguments to support their positions. At this time, supporters are convinced CPEC is a game changer while those opposed to the party believe it is a recipe for disaster. The former claim Nawaz Sharif is an astute industrialist and China a trusted friend, which invents irrelevancy to the debate. Let's take a neutral stand.

Pakistan has been suffering from acute economic crisis; around this catastrophe we can believe that the \$55bn investment has the potential to rejuvenate Pakistan's economy. So, this should be a welcome step. However, problem lays around the opaqueness of the project details. Pakistan government has been reluctant in sharing

the terms and details of CPEC in public. Many times, ministers have been quoted spreading inadequate or complete misinformation about the project. For instance, during the year of 2016 the major "pillars" of the project were considered to be energy and Infrastructure. However, after dawn's may 16 report, the preconceived notion was eradicated by the inclusion of Agriculture, Fiber-optics and tourism. The net result is that people are genuinely surprised to learn that there is a lot more to CPEC than what they imagined, which is roads, power plants and Gwadar. This is a pattern that repeats itself throughout the time when the government was engaged with their Chinese counterparts on the long term plan. The information that has been drip-fed to the public and stakeholders is always selective, vague, and thoroughly sanitized. Due lack of details, my own analysis is partly based upon the report of dawn. However, the government of Pakistan completely disregarded the report and termed it as "factually incorrect". In a response to this, On May 16, Dawn published an editorial in an apparent response to the government's rejection that the former's report was based on a "redundant document" and was angled to malign the project. The editorial notes that the

***About BILGESAM***

Established in 2008, the Wise Men Center for Strategic Studies (BILGESAM) is one of the leading think tanks in Turkey. As a non-profit, non-partisan organization BILGESAM operates under the guidance of a group of well-respected academics from different disciplines, retired military generals and diplomats; and aims to contribute regional and global peace and prosperity. Closely following the domestic and international developments, BILGESAM conducts research on Turkey's domestic problems, foreign policy and security strategies, and the developments in the neighbouring regions to provide the Turkish decision-makers with practical policy recommendations and policy options.

---

***“ Suriye’deki askeri varlığını güçlendirmekle Rusya’nın Orta Doğu’ya yeniden döndüğü ve kalıcı olmak istediği aşikârdır. ”***

---





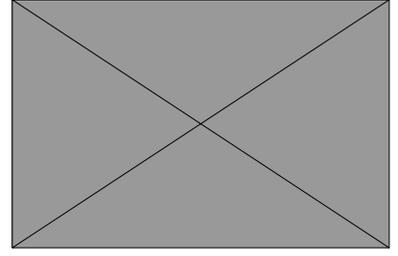
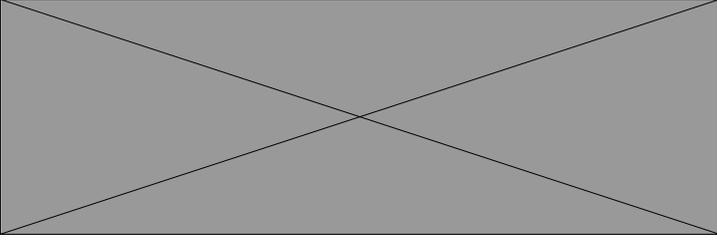












Prof. Dr. Atilla Sandıklı  
BİLGESAM Başkanı







