

REPORT



**Islamabad
Policy Institute**

Supporting Dialogue for Peace & Development

BRI & CPEC: Venturing into the Future

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CONTENTS

Foreword.....	i
Introduction.....	01
1. Belt and Road Initiative Background.....	02
1.1. OBOR Vision and Objectives.....	02
1.2. OBOR Elements.....	03
1.3. Six Economic Corridors.....	03
1.4. Areas of Co-operation.....	07
1.5. First Belt and Road Forum.....	08
1.6. Second Belt and Road Forum.....	09
2. CPEC: The BRI Flagship.....	10
2.1. Challenges facing CPEC	11
2.1.1. Domestic Challenges.....	11
Political instability	
Security Concerns	
Economic woes	
2.1.2. Regional Dynamics.....	14
3. The Institutional Framework of CPEC.....	15
4. Current Status of CPEC and Future outlook.....	16
4.1 Energy.....	17
4.2. Gwadar.....	19
4.3. Infrastructure.....	20
4.4. Socio-Economic Development.....	21
4.5. Special Economic Zones.....	22
5. Policy Recommendations.....	23
6. Conclusion.....	24

FOREWORD

I would like to commend the Islamabad Policy Institute (IPI) for producing a very useful and informative document on the China-Pakistan Economic Corridor (CPEC), which is the flagship and pilot project of the Belt & Road Initiative (BRI).

The timing of this document is relevant since it has coincided with the convening of the 2nd BRI Forum in Beijing, which is the biggest global gathering in recent history that is being participated by 5000 representative of over 100 countries including 37 presidents and prime ministers. The BRI is the biggest diplomatic and developmental initiative of the 21st Century, which was launched in 2013 and since then, it has been a success story especially CPEC.

CPEC has resolved Pakistan's chronic energy crisis, revived dead projects like Gwadar Port and Thar coal, given gainful employment to 7000 Pakistanis. Furthermore, CPEC is uniting the Federation of Pakistan, bringing together the less developed areas in the quest for a better tomorrow.

Almost 90 years ago, the great poet of the East, Allama Muhammad Iqbal had predicted the resurgence of Asia and the rise of China. As the BRI exemplifies the shift in the global balance of economic and political power, the prediction of Allama Iqbal is being proven.

Pakistan is proud to be a part of this historical transformation, playing a pivotal role in regional connectivity, driven by economy and energy, ports and pipelines, roads and railways, thanks to our "Iron Brother", China.

I wish IPI greater success in disseminating knowledge and information about issues that are vital for Pakistan and its people.

Senator Mushahid Hussain Sayed

Chairman, Senate Foreign Relations Committee

Chairman, Pakistan-China Institute

Introduction

The second Belt and Road Forum (BRF) is being held from April 25 - 27, 2019 in Beijing. The growing importance of the Forum in the international arena is evident from the participation of heads of state and government from 37 countries as compared to 29 leaders, who attended the first edition held in 2017. The meeting is expected to set new priorities for cooperation under the Belt and Road Initiative (BRI), improve the quality of cooperation and develop a cooperation framework for the 124 countries and 29 international institutions that are part of the initiative.

BRI is in its sixth year of development. Beijing is engaged in bilateral and multilateral cooperation with countries along the BRI corridors. The Silk Road Economic Belt (SREB) comprising of six overland corridors, and the 21st Century Maritime Silk Road (MSR) are aimed at connecting Asia, Africa and Europe through land and sea. China-Pakistan Economic Corridor (CPEC), termed as flagship project of BRI intersects both SREB and MSR. The timely completion of CPEC, as planned by China and Pakistan, will, therefore, be a manifestation of the success of BRI.

While the second BRF will take stock of state of BRI cooperation and lay out a new roadmap for future, it is equally imperative to examine state of CPEC cooperation under BRI framework. On the eve of second BRF, this special report first gives a background of the BRI, its vision and elements including brief introduction of overland and maritime corridors. It also brings out areas of policy collaboration identified by China for successful completion of BRI. The second section gives an overview of the first BRF, its outcomes and also provides an introduction of the second BRF. The third section delves into the progress made under CPEC. It explores strategic, development and regional dynamics associated with CPEC and the challenges confronting Pakistani policy-makers in timely and successful operationalization of CPEC projects and routes. Fourth section, explores the current state of cooperation in all sectors and also charts likely course of evolution in short-to-medium term. The report concludes with a set of recommendations for Pakistani and Chinese policy-makers as CPEC enters the next stage with an expanded scope.

1. Belt and Road Initiative

Background

In 2013, President Xi Jinping launched China's Belt and Road Initiative (BRI) with the goal to connect major Eurasian economies through infrastructure, trade and investment. In September 2013, in a speech at Kazakhstan's Nazarbayev University, President Xi Jinping proposed building of the Silk Road Economic Belt. In October, 2013, while addressing Indonesian parliament he put forward idea of reviving the Maritime Silk Road, and called for cooperation amongst China and Southeast Asian nations. Few weeks later addressing a Chinese Communist Party (CCP) forum on 'periphery diplomacy', President Xi emphasized that China remains committed to peaceful and mutually beneficial relations with its neighbours. He stressed China desires an environment in which Chinese neighbours can benefit from China's growth and development, and similarly, China will also benefit from a prosperous neighbourhood. It marked a direct linkage of 'Chinese dream' with regional development, and thus, was born the New Silk Road initiative.

1.1. OBOR Vision and Objectives

Belt and Road initiative is aimed at improving existing and creating new trading routes, connectivity, and business linkages with China, and 60 countries along the way, across Asia, Europe, the Middle East and Africa. The aims of BRI are threefold:

- i. Developing prosperity for underdeveloped parts of China, particularly in the West of the country.
- ii. Developing new opportunities for China to partner and co-operate with the various countries along the routes, many of which are developing countries.
- iii. Increased integration, connectivity and economic development along both routes.

In recent years, China has also sought entry into new markets and invested overseas to provide an outlet for domestic overcapacity that resulted from the economic drive and economic boom of recent decades. BRI is, therefore, being seen as a viable way for shifting out of excess production capacity. Moreover, in the past three decades, China has, on the back of remarkable economic growth and industrialization, accumulated large amount

of foreign exchange reserves and capital. BRI, therefore, opens new vistas for foreign investment across the continents.

China's National Development and Reform Commission (NDRC), Ministry of Foreign Affairs and Ministry of Commerce are leading Chinese efforts for implementing OBOR. NDRC is playing the role of coordination between various Chinese government agencies and foreign governments.

1.2. OBOR Elements

Belt and Road Initiative comprises two major elements:

a) One Belt: The Silk Road Economic Belt (SREB)

It is envisioned as a 'Eurasian land bridge', which will be a logistics chain from China's east coast all the way to Western Europe (Rotterdam). SREB aims to connect Asia, Europe and Africa along following three routes:

- i. Connecting China to Europe through Central Asia and Russia.
- ii. Connecting China with the Middle East through Central Asia.

- iii. Connecting China and Southeast Asia, South Asia and the Indian Ocean.

Chinese government has envisioned development of number of economic and trade corridors connecting China with Mongolia, Russia, Central Asian States, Pakistan, and South East Asian Nations along the route.

b) One Road: The 21st Century Maritime Silk Road (MSR)

It is a sea route, with reference to old maritime Silk Road, which uses China's coastal ports. It runs west from China's east coast to Europe through the South China Sea and the Indian Ocean and east into the South Pacific. Two routes of 21st Century Maritime Silk Road are:

- i. Linking China with Europe through the South China Sea and Indian Ocean.
- ii. Connecting China with the South Pacific Ocean through the South China Sea.

1.3. Six Economic Corridors

OBOR framework proposes development of above mentioned five routes, which encompass more than 60 countries accounting for nearly 60 percent of the

global population and approximately 33percent of global GDP. These five routes will be built through setting up of six international economic corridors. These economic corridors will enhance connectivity and trade by deepening China's existing partnerships with neighboring countries. Moreover, new multilateral mechanism will also be developed to facilitate trade and transport of goods and movement of people. Six economic corridors to be established outside China and proposed as part of the OBOR initiative are:

I. New Eurasian Land Bridge

It is also termed as Second or New Eurasian Continental Bridge. It is planned as international railway line running from port of Lianyungang in China's Jiangsu province through Alashankou in Xinjiang all the way to Rotterdam (Holland) in Western Europe. The China section of the railway line includes Lanzhou-Lianyungang Railway and the Lanzhou-Xinjiang Railway, and also runs through Eastern, Central and Western China. After exiting Chinese territory, it passes through Kazakhstan, Russia, Belarus and

Poland, and finally reaching coastal ports in Europe.

II. China - Mongolia - Russia Corridor

This corridor envisages trilateral cooperation between China, Mongolia and Russia to expand their existing economic cooperation. This corridor is aligned with China's Belt and Road Initiative, Russia's Transcontinental Rail Plan (the renovation of Eurasia Land Bridge to develop rail and road links between Moscow and Beijing), and Mongolia's Steppe Road Program (the plan to build five projects comprising road and rail infrastructure, and, oil and gas pipelines). Trilateral collaboration and cooperation on these three projects is intended to build high-speed rail and road networks among three countries. The route of this corridor is divided into:

- Beijing/Tianjin/Hebei to Russia (via Hohhot, Inner Mongolia)
- Dalian to Chita in Russia (via Shenyang, Changchun, Harbin, Manzhouli and Inner Mongolia)

China, Mongolia and Russia, through their trilateral cooperation, aim to enhance rail and road connectivity, ensure a single point custom clearance and transport facilitation, and broaden collaboration in a variety of fields.

III. China - Central Asia - West Asia Corridor

This corridor is envisioned as an important gateway for oil and natural gas, running to Xinjiang from the Arabian Peninsula, Turkey and Iran. China-Central Asia-West Asia economic corridor will run from Xinjiang in China, and exit Chinese territory via Alashankou to connect with railway networks of Central Asia and West Asia, before reaching Mediterranean coast and Arabian Peninsula. The corridor spans five Central Asian States of Kazakhstan, Kyrgyzstan, Tajikistan, Uzbekistan and Turkmenistan, and Iran and Turkey in West Asia.

To build this corridor China has entered into talks with Central Asian nations and Middle Eastern governments. At the third China-Central Asia Co-operation Forum,

held in June, 2015, participating governments announced a commitment to ‘jointly build the Silk Road Economic Belt’. Moreover, China has also signed bilateral agreements with Tajikistan, Kazakhstan and Kyrgyzstan to develop the China-Central Asia-West Asia corridor.

IV. China - Indochina Peninsula Corridor

This corridor envisions to connect Pearl River Delta Economic Circle (around Guangzhou, Hong Kong and Shenzhen) with the South-East Asian countries of Cambodia, Laos, Myanmar, Thailand and Vietnam. As part of the OBOR, China plans to construct new high-speed railways and motorways network which will link Pearl River Delta in South China to Singapore via Nanning in Guangxi Province and Hanoi in Vietnam. Enhanced connectivity and infrastructure development on this route compliments the Greater Mekong Sub- Region, an economic area for industrial and infrastructural development along the Mekong River proposed by Asian

Development Bank.

China has proposed expanding relations and cooperation with five countries of Indochina Peninsula. China seeks joint planning and construction of an inter-connected transportation network, development of industrial projects, mutual fund raising for projects and sustainable and coordinated economic development.

V. China - Pakistan Economic Corridor

Envisioned to link Kasghar in Xinjiang, in the north, with deep-sea port of Gwadar, in Balochistan province, in the south of Pakistan, this corridor is a flagship project of the OBOR Initiative. The nearly 3000km long corridor will provide China an alternate to connect with Middle East and Africa via Dubai and Oman bypassing the strategically sensitive Strait of Malacca.

Both nations, in April, 2015, pledged to proactively construct the corridor and deepen cooperation on projects including Phase-II for up gradation and renovation of Karakoram Highway, which links

China and Pakistan. Both governments have mapped out plans to construct a new international airport in Gwadar, a motorway from Karachi to Lahore, a rapid passenger train line in Lahore, exclusive economic zones and a China-Pakistan cross-country fibre-optic network. It is expected that CPEC will be a priority component of OBOR.

VI. Bangladesh - China - India - Myanmar Corridor

China also envisions connectivity with South Asian nations including, India, Bangladesh and Myanmar. It plans to link Kolkata with Kunming, the capital of China's Yunnan province, passing through Myanmar and Bangladesh, with Mandalay and Dhaka among the focal points. It will be 2800km road network connecting four countries. The Bangladesh-China-India-Myanmar economic corridor will increase Chinese integration with South Asia and beyond. The four countries have established a working group to explore areas for cooperation and development as part of the corridor project. China has proposed

cooperation in infrastructure development, including of railway network, industrial cooperation and professional training services.

1.4.Areas of Co-operation

Belt and Road Initiative envisages bilateral (China and its neighbors) and multilateral cooperation in following key areas:

- **Policy coordination**

Mutual consultation on national development policies and plans, and addressing issues through consultation, while providing a joint mechanism for project implementation.

- **Facilitating connectivity**

Infrastructure development will be prioritized as part of the OBOR framework. Barriers will be removed, development work will be expedited, and work on port infrastructure facilities will be advanced through mutual consultations. The connectivity of infrastructure facilities, including railways, highways, air routes, telecommunications, oil and natural gas pipelines and ports, will also be promoted.

- **Enhancing trade**

Efforts will be made to expand the volumes of bilateral and regional trade and promote regional trade integration. Moreover, steps will be taken to resolve the issues that hinder investment and trade, whereas policy will focus on deepening trade, and initiating trade development through investment.

- **Financial integration**

Coordination in monetary policy will be enhanced through mutual consultation and cooperation. At the same time, steps will be taken to broaden scope of financial settlements in local currency, and actions will support currency exchange in trade and investment between countries along the OBOR route. Countries will expand bilateral and multilateral financial cooperation and develop regional financial institutions and new mechanisms to monitor and manage financial risks through regional cooperation.

- **People-to-People exchange**

Countries will make efforts to promote people-to-people contact and dialogue between diverse cultures, thereby strengthening existing bonds and

deepening mutual understanding. This will form the solid foundations of the regional cooperation and economic integration as envisioned by OBOR initiative.

1.5. First Belt and Road Forum

China hosted the inaugural Belt and Road Forum for International Cooperation on May 14-15, 2017. Heads of States and Governments from 29 countries, from different regions, attended it, while a large number of countries sent high-level delegations. It was a major diplomatic occasion for China. It was also the highest-level and the largest diplomatic event held by China since the announcement of BRI by President Xi Jinping in 2013. It was, thus, aimed at show-casing international credentials of BRI to the global community, and making BRI less China-centric. It demonstrated that BRI can serve as a platform for enhancing global connectivity.

First BRF comprised an opening ceremony, a round-table summit, and a high-level conference with six parallel themes on eight areas including investment in infrastructure and industry for cooperation. Several goals were accomplished at the maiden BRF. Firstly, with the participation of around 130 governments and 70

international organizations, consensus was reached on enhancing policy coordination. Unexpectedly, delegations from the United States, Japan, and South Korea also attended the meeting. Secondly, new areas of cooperation were identified during both formal and informal discussions at the BRF. International community, particularly multilateral organizations, gained a better understanding of the BRI framework and the various projects underway in different countries. It was emphasized by Chinese hosts that aside from infrastructure development and trade cooperation, BRI is also focusing on establishing new free trade zones and incubation centers for technology and innovation to stimulate economic growth in developing countries.

In a crucial accomplishment, BRF led to signing of 32 trade and financial agreements between China, and other countries, and international organizations involved in BRI. These agreements allowed China to further internationalize its currency RMB, and enhance financial linkages with international organizations. China, on its part, committed to utilizing syndicated loans from insurance companies, sovereign wealth funds and private equity funds in financing of BRI projects. Moreover, China committed to engage international

development banks in research on economic development in developing countries and multilateral cooperation in development.

1.6. Second Belt and Road Forum

The second BRF will provide an opportunity to review the progress made towards implementation of various BRI projects and corridors since the inaugural Forum. A crucial development since the last BRF meeting has been the enshrining of BRI in the Constitution of Communist Party of China, thus, making it the national development project of China. BRI now requires a concrete roadmap for next five years after an evaluation of the past five years. Although Italy's participation in BRI, which was announced recently, was a major development, but over the past two years, BRI has generally received substantial criticism from many countries and international organizations. BRF would, therefore, provide an opportunity to China to respond to the criticism, gauge global perceptions of the BRI, and reset the global conversation about BRI and its various projects.

BRI also needs to be integrated into global businesses. The inaugural edition of the forum focused on government and think-

tank community. Chinese President Xi Jinping announced in October, 2018, that business community of Asia-Pacific countries would be welcome to attend the second Forum in April, 2019. The second BRF is, moreover, taking place in the backdrop of on-going trade war and talks between the United States and China. Impact of these talks will have direct implications for the global economy, and particularly the economies of countries directly linked with China. Beijing, thus, will use second BRF to give a direction to globalization.

The Chinese, besides, setting the priorities of cooperation among BRI countries at the second BRF, intend to emphasize on 'quality of cooperation' at the Forum. It is expected that the Forum will yield a number of inter-governmental agreements and projects involving the private sector. The hosts are also looking at developing a cooperation framework that envisages:

- Strengthening bilateral cooperation between China and individual BRI partners by aligning the objectives of their projects with the priorities of the partners.

- Encouraging trilateral cooperation in BRI projects by bringing in third partners in bilateral projects. Similarly China would persuade BRI partners to cooperate in third markets.
- Increasing cooperation with multilateral financial institutions for development of BRI projects.

2. CPEC: The BRI Flagship

CPEC is an economic project with strategic undertones. CPEC proposes enhanced connectivity and trade between both countries through a network of road, rail, communications and energy pipelines. In essence it is an investment package—consisting of roads, railways, pipelines and a port.¹ Gwadar, a port in Pakistan's south-western Baluchistan province is to be linked with Xinjiang, China's western-most autonomous region. It gives Beijing a coveted access to the Indian Ocean. It, thus, requires up gradation of road infrastructure, railway system, pipelines, port facilities, energy production, and security and stability in Pakistan. CPEC also envisions formation of Special Economic Zones, industrial parks,

trade centers, development of energy sector and economic and technical cooperation. To realize this vision both countries have signed more than 50 agreements/MoUs relating to infrastructure, energy, and communications sectors during the visit of President Xi Jinping to Pakistan, in April, 2015. Consequently, Pakistani policy-makers have presented CPEC as a strategic project and an economic development initiative.

Commencement of CPEC has qualitatively transformed bilateral strategic relationship. CPEC is a component of BRI, a grand-initiative launched by China in response to the U.S. led 'Rebalance to Asia-Pacific'.² By connecting with Eurasian heartland, through overland corridors and sea-lanes³ China is expanding its own geopolitical space in the Eurasian region. Geopolitically, the United States excluded Pakistan from its 'pivot to Asia' strategy. Consequently, Pakistan has been critical of deepening Indo-U.S. strategic relationship aimed at balancing rise of China and building-up India as a major Asian power.

¹ Baqir Sajjad Syed, "Pakistan-China ties' strategic content to be bolstered", DAWN, April 21, 2015, <http://www.dawn.com/news/1177236/pakistan-china-ties-strategic-content-to-be-bolstered>

² Hillary Clinton, "American's Pacific Century, Foreign Policy", October 11, 2011, <http://foreignpolicy.com/2011/10/11/americas-pacific-century/>

³ "Vision and Actions on Jointly Building Silk Road Economic Belt and 21st-Century Maritime Silk Road", National Development and Reform Commission, March 28, 2015. http://en.ndrc.gov.cn/newsrelease/201503/t20150330_669367.html

Beijing aims to connect landlocked Xinjiang region to Arabian Sea via Gwadar. It will provide China an alternate route for its trade bypassing Strait of Malacca. It will also provide strategic space to Pakistan to advance its national security interests in the region.

Meanwhile, CPEC is an economic development initiative. After a decade of internal conflict Pakistan requires investments in critical sectors of economy: energy and infrastructure to revive economy and address chronic energy crisis. More than 60 percent of investments under CPEC framework are geared towards electricity generation projects in four provinces of Pakistan. Early-harvest projects will add more than 5000MWs of electricity to the national grid. This will directly address the crippling electricity shortages and provide power to consumers and industry. At the same time, CPEC also focuses on infrastructure construction improving connectivity between major cities and towns across the country. Lahore and Karachi are being connected through a motorway. Gwadar is being linked with the rest of Balochistan and up-country through new highways. Karakoram highway is being upgraded to improve connectivity between Xinjiang and Pakistan.

2.1. Challenges facing CPEC

As a strategic and development project, where CPEC opens new opportunities for Pakistan, it also brings host of new challenges that have the potential to impede development process. Broadly these challenges can be viewed into two categories: a) domestic and b) regional.

2.1.1. Domestic Challenges

Pakistan faces multitude of domestic challenges. Three of them are critical for smooth operationalisation of CPEC. These include: political instability, security concerns and economic woes.

i. Political Instability

Unstable political system and polarized politics is the major stumbling block in the pursuit of sustained economic and development policies. CPEC has already suffered political instability in recent years. In 2014, PTI led sit-in in Islamabad on political issues forced Chinese President Xi Jinping to postpone his state visit to Pakistan. Though the issue has been resolved and PTI has also played constructive role in supporting CPEC, but the threat of

instability is not over. In July, 2017, judicial disqualification of Prime Minister Nawaz Sharif also led to another wave of instability in the country. It put fate of CPEC projects and policy-framework in jeopardy as the then PML-N was sucked into vortex of domestic politics and resultantly its attention was diverted from governance.

Another political challenge is politics of CPEC routes. Major political parties support CPEC but disagree on selection of routes and allocation of funds. There are three overland routes to link Kashgar with Gwadar—western, central, and eastern. The western alignment is the shortest route followed by the central and eastern alignments. The major disagreement has been on priority of development of these routes. Smaller provinces like Khyber Pakhtunkhwa and Balochistan in the past alleged that PML-N led federal government changed the original route, to benefit Punjab. The western route still requires attention. Chinese side contends priority should be given to eastern route as it has developed cities and considerable population

along the way. On the contrary, western route demands greater investments in infrastructure and provision of facilities, before it is ready to absorb industrialization. Dispersed population along western population means cost of doing business and security increases manifold.

The lack of political consensus on routes of CPEC can have a negative effect on the implementation of CPEC considering the historical grievances and center-province relationship in the federation.

ii. Security Concerns

Future success of CPEC depends on secure environment in the country. In this sense, security concerns are the primary challenge to CPEC. From Xinjiang to Gwadar militant groups are active. These groups include East Turkestan Islamic Movement (ETIM), Tehreek-e-Taliban Pakistan (TTP), Lashkar-e-Jhangvi (LeJ), Daesh (ISIS), Balochistan Liberation Army (BLA), Balochistan Liberation Front

(BLF) and militant wings of certain religious and political parties. Some of these groups are directly challenging Pakistani state, and can potentially attack Chinese personnel and projects in Pakistan. Such groups might not have direct issues with China but may still target Chinese interests to send across a message to the Pakistan State. At the same time, there are groups, which are in conflict with China or allied with groups involved in conflict with China. In a number of incidents, these terrorist groups have targeted Chinese workers and engineers in the past. ETIM in particular has direct security concerns against China. It thus can target Chinese personnel in Pakistan.

Besides these concerns, religious extremism also poses a security threat to CPEC. Extremism is spreading fast in Pakistani society in recent years and the country has witnessed emergence of new far-right religious parties in political arena. As these parties expand their footprint, religious extremism will deepen.

Recent terrorist incidents in Balochistan involving Lashkar-e-Jhangvi, Daesh and Baloch terrorists underscore the fragile security situation in Balochistan. Baloch Liberation Army (BLA), a banned separatist group, in the second half of 2018 carried out two attacks against Chinese targets within three months including one on Chinese Consulate in Karachi. The BLA had in August targeted a bus carrying Chinese engineers in Dalbandin. Five people, including three Chinese nationals, were wounded in that attack. The Dalbandin attack had marked a change in BLA's tactics against the Chinese as it was the first suicide attack on their engineers. The BLA had remained staunchly opposed to CPEC.

Lashkar-e-Jhangvi, which has developed a close nexus with Daesh, is also a serious threat to Chinese projects and personnel. LeJ/Daesh have carried out attacks against Chinese including the abduction and killing of Chinese from Quetta in 2017.

iii. Economic woes

As an economic enterprise, economic challenges are most pressing for CPEC. Pakistan has been facing constant pressures on its current account deficit and foreign exchange reserves. Every few years Pakistan has been seeking a stabilization package from International Monetary Fund (IMF) and multilateral donors. Such policy choices also impact Pakistan's policy framework related to CPEC. To avoid being pushed into making hard choices, Pakistan would have to initiate far-reaching and much desired economic reforms to expand its tax revenues, increase its exports and earn vital foreign exchange to be self-sufficient.

Both Chinese and Pakistani sides have time and again insisted that CPEC projects were not aggravating Pakistan's current account deficit. It is said that a loan of \$19 billion was incurred under CEC over the past five years, out of which \$13 billion are commercial loans between firms here and the Chinese banks and companies (not the national loan), whereas \$6 billion

are the government to government loans on soft terms. It is further said that no repayments are due over the next five years because the maturity time of these loans is longer.

2.1.2. Regional Dynamics

External challenges to the implementation of CPEC mainly comprise the security situation in Afghanistan and the competing interests of Pakistan's neighbours India and Iran. Moreover, the broader strategic rivalry between China and the United States will also impact the course of CPEC implementation.

On-going conflict in Afghanistan directly impacts security situation in Pakistan. Islamabad will be unable to ensure internal security as long as violence continues in Afghanistan.

India, the arch-rival, opposes CPEC publicly. New Delhi has gone a step-ahead and opposed Chinese Belt and Road Initiative. Indian opposition can be seen at two levels: a) against Pakistan and b) against China. For New Delhi, China is a strategic competitor. It views CPEC as Chinese attempt to expand its

footprint in Pakistan and South Asia and the Indian Ocean Region.

The U.S. views the CPEC in terms of its long-term strategic impact. The control of Gwadar port gives leverage to China in the Indian Ocean, a potential threat to the supremacy in the oceans that U.S. naval forces currently enjoy. The growing U.S.-Indian strategic relationship in the last decade is evidence of the United States encouraging and supporting Indian naval power to counter the growing Chinese influence in the Indian Ocean.

3. The Institutional Framework of CPEC

Pakistan and China are undertaking CPEC cooperation through an institutional framework of Joint Cooperation Committee (JCC). This decision-making body is co-chaired by Pakistan's Federal Minister for Planning Development and Reform and China's Vice Minister for National Development and Reform Commission. At JCC meetings major decisions regarding CPEC projects, their timelines, and financial framework are taken with mutual consensus. In 2017, JCC approved the Long-Term Plan

(2017-2030) giving a strategic direction to CPEC.

JCC is further divided into eight Joint Working Groups comprising experts and officials from both countries. These groups include:

- i. Planning Joint Working Group
- ii. Energy Joint Working Group
- iii. Gwadar Joint Working Group
- iv. Transport Infrastructure Joint Working Group
- v. Security Joint Working Group
- vi. Industrial Parks/Special Economic Zones Joint Working Group
- vii. International Cooperation and Coordination Joint Working Group
- viii. Social and Economic Development Joint Working Group

Each specialized working group undertakes feasibility study of proposed projects and after detailed discussions forwards them to JCC for political approval. These groups also continuously monitor state of on-going projects and work to address any bottlenecks that emerge.

4. Current Status of CPEC and Future outlook

Since coming into power Pakistan Tehrik-i-Insaf (PTI) government has influenced the course of CPEC cooperation. PTI government started by undertaking a comprehensive review of the CPEC framework, as it, during its days in Opposition, remained critical of a number of mega-projects and the excessive focus on infrastructure building. This set the stage for different set of expectations from CPEC in Pakistan in the short-to-medium term. PTI had argued that it will seek renegotiation of existing CPEC related contracts and their terms and conditions. This was articulated by Advisor to the Prime Minister on Commerce and Industries, Mr. Abdul Razzaq Dawood in an interview with *Financial Times*.⁴ He argued for re-evaluation of the projects and proposed slowing them down. The tone and tenor of the interview reflected the new government's approach on CPEC. Its timing was also odd, as that interview was published at a time when Chinese Foreign Minister Wang Yi was visiting Islamabad.

⁴<https://www.ft.com/content/d4a3e7f8-b282-11e8-99ca-68cf89602132>

As the PTI government undertook the review of CPEC projects, it missed an important point: CPEC is a component of China's larger Belt and Road Initiative (BRI). PTI wanted China to realign its goals for CPEC according to the agenda of PTI government. Beijing, however, was looking at a much broader picture where BRI encompassed cooperation with more than 60 countries in four continents. This naturally meant a difference in the lens from which China and PTI government viewed the project. This was on display during Prime Minister Imran Khan's visit to China in early November. Pakistan pushed for expanding cooperation in new areas such as socio-economic development, agriculture and poverty alleviation. But, still the Chinese leadership promised to adapt to Pakistan's new agenda.

Recently, both countries agreed to focus on "industrial, socio-economic and agriculture cooperation" during 2019. This has emerged from of the 8th JCC meeting held in December, 2018, where Pakistan sought further financial assistance, and Beijing called for more facilitation, enhanced security and a reliable repayment system. Islamabad, beset by a financial crisis, is seeking various forms of financial

support such as grants, investments, concessional loans and joint ventures to shore up its depleting foreign reserves and boost local economy. Beijing, on the other hand, is pushing for putting in place a mechanism that can allow Pakistan to fulfill its financial obligations to Chinese companies, particularly, in the energy sector. Moreover, in the wake of attack on Chinese consulate, Beijing has emphasized on accelerating the process of forming and deploying Special Security Division-South to meet the emerging security challenges. In this backdrop, following section will review the current state of bilateral cooperation in key sectors of CPEC and its likely evolution in short-to-medium term.

4.1. Energy

During the first phase of CPEC, focus remained on addressing Pakistan's energy crisis. Pakistan invited Chinese companies to invest in power sector and establish power plants, mostly coal based. As part of Early-Harvest Projects (EHP) three coal-based power plants, each of 1320 MWs, were constructed and operationalized in Sahiwal⁵ and Port-Qasim⁶ with investment

from Chinese companies. Alongside coal-fired power plants, around 600MWs of electricity is being generated from solar and wind power plants established in South Punjab and Sindh. Collectively, these projects have added 3900MWs of electricity to Pakistan's national grid over past five years.

Of various energy projects, three coal power plants require special mention. First, Sahiwal coal power plant in Qadirabad district of Punjab has been constructed at the cost of \$1.8 billion. It is also based on supercritical technology and uses imported coal to produce electricity. Its construction began in July, 2015, while it began producing electricity in May, 2017. Its second unit was connected to national grid in June, 2017, again, six months ahead of the schedule. It was the first large-scale energy project completed under CPEC. During the construction phase more than 3000 Pakistani engineers and laborers were employed. Later in the operational phase 200 Pakistani engineers have been recruited on a long-term basis.

⁵Details of Coal-fired power plants at Sahiwal, Karachi can be found here: <http://cpec.gov.pk/project-details/2>

⁶Details of Coal-fired power plants at Port Qasim, Karachi can be found here: <http://cpec.gov.pk/project-details/1>

Second, Port-Qasim coal-fired power plant has been set up near Karachi at the cost of around \$2 billion. It was designated as a priority energy project under CPEC. It involved construction of 2x660 MWs (total 1320 MWs) power plants based on supercritical technology. The construction work commenced in May, 2015. The first unit of the project began power generation in November, 2017 and the second unit was connected with national grid in January, 2018. It was completed six months before its scheduled commercial operational date. The project employed over 5000 Pakistani engineers and laborers during the construction period, while 300 jobs have been created during the operational phase.

Third, is the Thar coal mining and power plant project in Sindh. Thar coalfield was discovered in 1991, but couldn't be mined due to lack of resources and technology. The project was added to CPEC. It entailed usage of local coal from Block I and II to power two units of 330MWs each to produce a total of 660 MW of electricity. Construction on the project commenced in April, 2016. The first unit was connected to national grid in March, 2019 and the second unit in April, 2019. The project is joint venture of Engro, Government of Sindh, Thal Limited, China Machine Engineering

Corporation, Habib Bank and Hub Power Limited. The consortium trained and employed over 1000 locals in construction phase of the project.

Government of Pakistan provided sovereign guarantees and committed to paying tariffs to Chinese companies against the electricity purchased from them. As Pakistan entered into a balance of payment crisis in 2018, the payments to the Chinese companies were delayed. In one instance, Pakistan owes around \$119 million to a Chinese company for operating the coal power plant in Sahiwal.⁷ Given Pakistan's financial difficulties, Chinese authorities have been emphasizing on establishing a mechanism that would allow Pakistan to clear outstanding payments of Chinese companies without hindrance.

Pakistan is faced with issues of line losses and inefficient recovery of bills from consumers. Deep structural reforms in power sector are required to meet financial obligations. Pakistan is seeking technical support from China to reduce line losses and move to net-metering for recovery of electricity cost.

⁷<https://www.nytimes.com/2018/12/19/world/asia/pakistan-china-belt-road-military.html>

Meanwhile, Pakistan is also interested in moving away from imported coal as a major source of its energy mix. Pakistan intends to move towards domestic sources of energy, particularly, hydropower as the main source.

Given these developments, it is most likely that coal-based power plants would not remain the mainstay of CPEC power projects. Pakistan has already requested China to scrap the 1320 MWs Rahimyar Khan coal power plant. Secondly, given Pakistan's difficulty in fulfilling commercial obligations Chinese companies are also expected to slow-down the pace of development work in case of ongoing projects. Moreover, operational power plants too are not likely to be run on full capacity. Addressing these issues require continuous consultations, both formal and informal, at the level of joint-working group focusing on energy issues.

4.2. Gwadar

Development of Gwadar port and city is an important component of the CPEC framework. At present a master plan of Gwadar as a smart port city is being finalized. A draft has been prepared and

submitted to Islamabad for approval.⁸ Following approval of the master plan by Pakistan's political leadership, development works will commence. Gwadar city requires a dedicated power plant, an international airport, hospital, vocational training facilities, and necessary road infrastructure to make the port commercially operational. Islamabad seeks to make Gwadar port a transshipment hub alongside a petroleum city. Pakistan has signed a Memorandum of Understanding with Saudi Arabia, during Crown Prince Mohammad bin Salman's visit to Islamabad in February, for establishing an oil refinery in Gwadar possibly along with a petro-chemical complex.

During the past year Pakistan and China had agreed to commence work on a coal power plant and an international airport in Gwadar. Unfortunately, no development work has been started on the ground. At the 8th JCC meeting, both sides reaffirmed their commitment to initiate work on airport, hospital and vocational training institutes within three months to gain support and trust of local people. China has pushed Pakistan

⁸<https://tribune.com.pk/story/1892965/1-gwadar-master-plan-delay-upsets-chinese/>

to provide tax breaks and tariffs concessions to companies that will begin manufacturing operations in Gwadar. Beijing believes such concessions will enable Pakistan to attract investment in Gwadar city.

China Overseas Ports Holding Company (COPHC) is leading the development of Gwadar Free Zone, which is meant to become the industrial hub of Gwadar. In 2018, first phase of construction of Gwadar Free Zone was completed, with building of a business center, trade exhibition hall, cold storage and a warehouse. In January, 2018, Gwadar Free Zone was inaugurated and first International Expo was also held. COPHC claims that nearly 30 companies have made investments in the Free Zone totaling an amount of nearly US \$474 million.

Undoubtedly, the future of CPEC centric cooperation is linked with development of Gwadar port and city. History is evident that port cities take decades to develop. The pace of development in Gwadar is, however, too slow. The development work on Gwadar port and city will remain slow as long as both sides do not finalize the Gwadar Smart City Master Plan.

4.3. Infrastructure

As a corridor, infrastructure development is at the heart of CPEC initiative. Infrastructure development is meant to promote connectivity, within Pakistan and overland with China. At present, upgradation of Karakorum Highway (KKH) Phase-II from Havelian to Thakot, Sukkur-Multan section of Karachi-Lahore Motorway, and Lahore Orange Line is underway as part of CPEC road infrastructure projects. Chinese government has provided concessional loans of around US\$ 5.8billion at an interest rate of around 2% p.a. for these projects. KKH project will improve connectivity with China, while Karachi-Lahore motorway will enhance intra-Pakistan connectivity and boost commerce.

A major part of infrastructure component of CPEC is upgradation and expansion of Pakistan's 150-year-old railway network. With Chinese funding Pakistan will modernize British-era railway tracks. Plans also include constructing new tracks to the Chinese border and to Gwadar, thus, improving connectivity and linking both ends of CPEC route via railway. Upgradation of Pakistan Railways Main Line-I from Karachi to Peshawar has been

declared a strategic project of CPEC. Given its strategic significance, Beijing is keen to finalize modalities and begin work on the ground. Islamabad, however, has reservations over the financial model and its high cost to the tune of US \$8.2 billion. PTI government undertook a comprehensive review of the project as it is sought to follow ‘build-operate-transfer’ model. China, on its end, showed willingness to provide up to 85 percent of the project financing. Technical package of the first stage of ML-I has been completed. It is likely that ML-I project will be undertaken in accordance with the Framework Agreement inked in May, 2017, whereby both countries will share project cost on 85%-15% percent basis.

Meanwhile, information highway project of laying optical fiber cable (OFC) from Rawalpindi to Khunjareb has been completed and operationalized. It included 820km of cable laying and related construction at the cost of US\$44 million.

4.4. Socio-Economic Development

The most significant adjustment into the CPEC framework has been the inclusion of socio-economic development projects. PTI government, and in particular PM Imran Khan has been emphasizing on emulating

Chinese socio-economic development model of reducing chronic poverty. In this regard, a joint working group on agriculture and socio-economic development has been formed.⁹ Both sides have identified areas of ‘agriculture, education, health, poverty alleviation, water and irrigation, and vocational training’ as the focus of socio-economic development centric cooperation. China will invest \$1 billion for establishing hospitals in Balochistan and Khybher Pakthunkhwa, up-gradation of vocational training centers, undertaking agriculture and water projects and providing scholarships to Pakistani students to study in China under socio-economic development program. An agreement to this effect would be signed during Prime Minister Imran Khan’s visit to China for attending the second BRF.

While both sides have committed to broadening the scope of CPEC cooperation, it remains to be seen if Chinese companies will follow the governmental commitment. Pakistan is seeking visits of Chinese experts to explore investment opportunities in agriculture sector and agriculture value chains to promote local economy.

⁹<https://www.thenews.com.pk/latest/431190-pak-china-cooperation-in-agriculture-to-be-extended-under-cpec>

Meanwhile, given the central role of agriculture sector in Pakistan's national economy, ingress by a foreign company will have to be managed carefully for it to be successful.

4.5. Special Economic Zones

At the time of launching CPEC, it was hoped that SEZs will become the engine of Pakistan's industrial development. Five years later little progress has been made on the ground. Recently, PM Imran Khan, directed the Board of Investment (BOI) to prioritize development of SEZs and make 2019 a year of industrial development under CPEC. In the first phase both sides have agreed to expedite work on Rashakai SEZ in Khyber Pakhtunkhwa, Dhabehji in Sindh and a high-tech SEZ in Islamabad. Meanwhile, Chinese apparel manufacturers are partnering with Pakistani companies based in local Faisalabad SEZ. Rashakai and Dhabehji first require provision of utility services and necessary infrastructure. The groundwork in this regard is underway.

Development of SEZs and their success is directly linked to Pakistan's taxation regime, incentives for investors and ease of doing business in the country. Besides these measures, federal and

provincial governments need to provide essential utilities at the SEZ sites. A governance model for SEZs also needs to be prepared at the earliest. At present, federal and provincial governments are at odds over various issues, since many of the subjects have been devolved to provinces. During 2017-18, Chinese experts evaluated Pakistan's proposed SEZ sites and have made feasibility studies of 6 SEZs so far. Beijing has suggested to Islamabad, that a distinctive development model for each SEZ be formulated with specific economic rationale keeping in view local conditions at each site and its distinct advantages.

Meanwhile, Chinese side is seeking one-window-operation to coordinate land, essential utilities, taxation, customs, and other legal issues related to development and operationalization of SEZs. Beijing has proposed to Islamabad that Board of Investment (BoI) be designated as the lead Pakistani government department dealing with all aspects and issues related to development and governance of SEZs. Notably, PM Imran Khan has tasked BoI to formulate recommendations for expediting the development of prioritized SEZs. It means that current government is giving priority to SEZs and the relocation of

Chinese industry in the next phase of CPEC cooperation.

Present government is looking at SEZs for job creation. Pakistan and China have been making efforts to incentivize Chinese investors to relocate part of Chinese industry, which has been earmarked for relocation overseas by China, to Pakistan in crucial sectors of textile, petrochemical, iron and steel among others. Pakistan needs an in-depth study for prioritizing sectors in which it is seeking Chinese investment, so that it doesn't happen at the cost of Pakistan's indigenous industry. Over the medium term, i.e. 3-5 years, SEZs will become the core of CPEC cooperation, and importantly the success of CPEC is linked to the success of SEZs. In particular, operationalization of Gwadar port is directly linked with operationalization of Gwadar Free Zone. Industry needs to be established in Gwadar. There is no gainsaying the fact that unless goods are manufactured in Gwadar city, port won't become a successful commercial venture.

5. Policy Recommendations

Pakistan should realize that CPEC is integrated with larger BRI framework. It provides Pakistani businesses opportunities

to tap into unexplored markets where BRI projects are underway.

- Addressing issues in energy sector requires a long-term energy policy and continuous coordination with Chinese side, both at expert level and political level.
- Gwadar Master Plan should be approved at the earliest, so that development work on Gwadar port and City could be expedited.
- For five years discussions on ML-I remained inconclusive. It has only been lately that technical package for first stage of ML-I has been finalized. Pakistan should, therefore, have detailed internal deliberations. A viable financial model should be adopted and a policy decision regarding putting Pakistan's national freight traffic on railway in the long-term should be taken to generate revenue.
- Legal and administrative bottlenecks in development of SEZs should be addressed.
- Council of Common Interests (CCI) should be the focal forum for addressing centre-provincial issues related to CPEC.

- A national regulatory regime for over-sight of CPEC related projects and investments should be introduced. It will streamline multiple regulations currently in place.
- CPEC related administrative, coordination, financial, and security issues should be cleared through one-window operation. A special CPEC board can be established under Prime Minister's Office (PMO) empowered through an Act of Parliament to oversee implementation of CPEC. This board shall also periodically brief CPEC Committees of National Assembly and Senate.

6. Conclusion

The bilateral relationship between China and Pakistan is important for both countries. In recent years level of trust has deepened as scope of bilateral cooperation expanded. Beijing is, nevertheless, currently feeling a little uneasy because of Pakistan's domestic politics. The unease is not baseless because realization of economic goals is directly linked with domestic political situation. Nonetheless, given the mutual trust and

history of cooperation, both sides have so far been able to navigate the difficulties they have encountered so far. There has to be a realization on both sides that they differ in their expectations from the CPEC cooperation.

Pakistan is in a financial crunch. It is looking to grants, investments and concessional loans from anywhere and everywhere. Islamabad had made a formal request to Beijing for financial assistance. In the short-to-medium term, economic pressures on Pakistan will constrain expansion of CPEC.

Beijing, meanwhile, is focused on completing the on-going projects. In short-to-medium term, there will be gradual slowdown with both sides reviewing and finalizing plans for next phase. The 'new stage' of CPEC with expanded cooperation has almost been finalized, which is based on enhanced involvement of private sector, activation of SEZs, social sector cooperation, and involvement of third country partners in CPEC projects. By including socio-economic cooperation into the CPEC framework, Beijing has indicated that it is willing to adapt CPEC to the priorities of the government in Islamabad. Such collaboration and communication

symbolizes the depth of bilateral relationship and its ability to adjust to new environment.

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