The China-Pakistan Economic Corridor: Five Years On

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November 2020

Abstract

Five years on, China's geostrategic aims for the $ 62 billion China-Pakistan Economic Corridor (CPEC) have remained constant. CPEC offers a strategic access from resource rich Western China to the Arabian Sea, lucrative projects for Chinese companies and finance institutions and an important economic support for a long-standing ally of China. CPEC has become China's flagship venture under the Belt and Road Initiative. Pakistan hopes that Chinese technological know-how and financing will help upgrade its power plant infrastructure, stimulate economic growth and develop Pakistan into a regional economic hub. The financing costs have increased Pakistan's external debt and contributed to its fiscal instability. The Pakistani military has been given a bigger power share in CPEC projects thereby reducing the role of civilian government. Pressure is mounting on Pakistan's PM Imran Khan and on China to ensure the efficacy and greater transparency of CPEC projects.

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Analysis

What is CPEC?

Major infrastructure projects were first announced by Pakistan and China during Pakistan's PM Nawaz Sharif's visit to China in 2013. The focus then was on connecting China and Pakistan's Gwadar port by highway, rail and a pipeline as well as on urgently needed power plants. Costs were projected to about 5–10 billion with a time frame of five years. This developed into a more ambitious economic master plan. During Chinese President Xi's visit to Pakistan in April 2015, both countries signed the agreement for a "China-Pakistan Economic Corridor" (CPEC) connecting both countries with a much larger number and variety of projects and easy access to Chinese loans and technology. The total combined costs of CPEC projects is estimated to be around US $ 62 billion, making the CPEC the flagship of China's Belt and Road Initiative. The CPEC - with a timeframe up to 2030 – now has a portfolio of some 58 projects, among them eight projects to develop Gwadar port, city and airport, 21 coal, hydro and solar power plants, power transmission lines and the construction of major highways and railways as well as a fibreoptic cable project. Some projects were added later and some were shelved. CPEC is termed a "framework of regional connectivity" which benefits both China and Pakistan.

China's CPEC goals

CPEC is China's biggest overseas investment within the framework of its 2013 Belt and Road Initiative (BRI). China and Pakistan have for many decades been close political, military and economic allies and important strategic partners. An economically prosperous and stable Pakistan was seen strategically advantageous to China. Strong military support of Pakistan also served as a convenient tool to keep China a player in the ongoing decades-old India-Pakistan enmity over Kashmir. It is therefore no coincidence that some projects are located in Pakistan-administered Kashmir, a point of strong contention for India.

China wants to create a connectivity corridor between its resource-rich but landlocked Muslim Xinjiang province and Pakistan's Gwadar city and port. The Chinese government is already developing the Xinjiang border city Kashgar into a Special Economic Zone and a starting point of the CPEC on the Chinese side. China aims to have direct access to the strategic Arabian Sea and shorter shipment time for strategic goods. The distance from the western Chinese provinces to Gwadar is shorter than to the Chinese port city of Shanghai. China sees the Pakistan's Arabian sea ports Karachi as well as Gwadar as an alternative sea route to the Straits of Malacca which could be blocked. Once fully developed, Gwadar has the potential to connect three regions: The Middle East, Central Asia and South Asia. Gwadar's strategic importance is obvious with its location at the mouth of the Gulf of Oman, just 75 km from the Iranian border. Gwadar port is close to the Strait of Hormuz, the strategic bottle neck and cross junction of vital international sea shipping and oil trade routes. Control of Gwadar port provides the opportunity to monitor oil related sea traffic coming through the Arabian Sea.

China sees CPEC as a good opportunity to revive a slowing Chinese economy and for Chinese financial institutions such as the Export-Import Bank of China to provide infrastructure finance to its neighbouring political ally. The CPEC projects give China the opportunity to export its technological expertise in the construction of power stations, transmission lines and roads. China sees the construction and administration of coal fired power plants within CPEC as good alternative business opportunities for its state-owned enterprises abroad at a time when coal fired power plant projects are being scaled down in China because of President Xi's stronger focus on sustainable power supply. China is investing in 21 energy projects: nine coal power plants, seven wind farms, three hydropower and two transmission line projects.

The opening up of the huge but dirty Pakistani Thar coal reserves is designed for domestic power plants. But it might also become a strategic alternative to Chinese coal imports from Australia. Both countries have recently been at diplomatic and economic loggerheads and have retaliated with respective import restrictions.

Pakistan's CPEC goals and ambitions

The previous Nawar Sharif Government (2013 – 2017) and the present Imran Khan led Government both hoped that projects with Chinese technological know-how and money would help upgrade Pakistan's ailing industrial infrastructure, revitalize its economic development and develop the country into a regional economic hub. Pakistan's perennial energy deficit with power shortages, frequent blackouts and power transmission losses combined with an increasing power demand of a growing population have been major challenges for every Pakistani government over the last decades. They also impeded economic development, especially in less developed provinces Baluchistan and Pakistan administered Kashmir. CPEC with its easy access to Chinese financing has promised to provide a fast solution to permanently solve the power shortage problem: Chinese financed fast construction of power plants and transmission lines would fill the capacity gap and give the consumers access to electricity at affordable prices. PM Sharif who had vowed to end power cuts, decided a switch from expensive oil to coal fired plants as the solution to Pakistan's energy problems. At Pakistan's request China's CPEC investments were mainly tied to the carbon intensive power sector. CPEC was also seen as a possibility to generate jobs among a growing young population.

The government hoped that a tax-free Gwadar port in the impoverished and long neglected Baluchistan province would help attract foreign investment and provide job opportunities. In 2013, the China Overseas Port Holding Company (COPHC) took over from the Singapore Port Authority and is now developing Gwadar into a deep sea port. Additionally, power generation plants, transport links to Karachi and to Gwadar's hinterland and an $ 300 Million airport are being built making Gwadar one of the biggest infrastructure projects within the BRI. Pakistan and China hope that Gwadar would eventually turn it into a trade and transport hub.

PM Imran Khan with his Tehreek-e-Insaf Party was elected in 2018 on an anti-corruption ticket and had vowed to renegotiate CPEC projects. However, a year later, both Pakistan and China continued with the majority of projects though some bigger ones were postponed. In fact, PM Khan sees completion of Gwadar port as his main priority and recently pledged "to complete CPEC at any cost" when he launched "CPEC Phase 2.0" (CPIC Global, 12.9. 2020). PM Khan also increased the military's role in the CPEC governance. In November 2019, he appointed retired Army General Asim Saleem Bajwa as Chairman of the newly created CPEC Authority. General Bajwa, was tasked to push ahead with stalled CPEC projects and to address an increasingly fragile security situation in Baluchistan province which threatened CPEC projects and Chinese business interests. Even though Pakistan managed the Covid pandemic comparatively well, its economy suffered. Some of the CPEC projects were stalled, but work has resumed in stages since June 2020. Pakistan and China even signed new contracts in June and July 2020 for two additional CPEC projects worth $3.8 billion (hydropower plants on the Jhelum river in Pakistan administered Kashmir) and in June, Pakistan gave the go-ahead signal for the delayed $ 7.2 billion for Mainline1 project (upgrading of the Karachi-Peshawar railway system). It was surprising for most observers that PM Khan agreed to this new commitment with China in spite of Pakistan's dire fiscal situation. Military associated business entities have been involved in CPEC projects with General Bajwa overseeing their

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implementation. In July 2020, a controversial CPEC Authority Bill was introduced before the Pakistan Parliament which "will empower the working authorities and assist them in removing any potential roadblocks ensuring timely completion of all ongoing CPEC projects" (China Pakistan Investment Corporation, CPIC Road Bloc). The Bill will grant CPEC – and indirectly the military - comprehensive powers. As a consequence, the governmental Planning Commission's power will be drastically weakened.

After corruption allegations regarding his family business empire surfaced, Bajwa stepped down as the PM's Special Advisor in September 2020, a position he had been appointed to in April 2020. The Prime Minister, however, retained him as CPEC Chairman. A visit to Pakistan by President Xi, carefully planned for September/October 2020, has just been postponed "due to Covid situation". Speculation was rife in the regional media that at this juncture, President Xi didn't want to be associated with a "corruption tainted" CPEC chairman.

What has been achieved?

Information on the progress of CPEC projects is rather opaque but PM Khan is claiming "substantial progress". Some projects have been subdivided into different stages, some are shelved, postponed or still seek financial closure. Observers guess that a quarter of the projects have been completed (J. Hillman). CPEC Chairman Bajwa recently announced "that nine projects have already been completed, producing 5,320MW of electricity with an investment of $7.9 billion. The energy generating projects have provided jobs to 5,000 Pakistani citizens." He added "that eight more similar projects are being constructed to generate 4,470MW electricity with an investment of another $9.55 billion and would provide employment to over 15,000 Pakistanis." (CPEC website) Among these are four fossil fuel power plants and one coal mine. The four renewable energy plants combined only produce 648 MW, a little more than 10 % of the CPEC produced power supply. Work on the Gwadar projects is advancing, the Lahore Metro Line and part of the 1100 km Peshawar- Karachi Motorway has been completed.

Five major problems

Increased fiscal instability

"Pakistan has been facing long-standing economic challenges, including low revenue mobilization, high fiscal deficit and indebtedness, … and a weak external position" (IMF, Pakistan, April 17, 2020). CPEC has contributed to its worsening fiscal situation. At the request of Pakistan, the International Monetary Fund (IMF) approved a 39-month extended arrangement in July 2019 under the Extended Fund Facility (EFF) for Pakistan for about US$ 6 billion to support Pakistan's economic reform program. The EFF program, the 22nd loan from IMF in three decades, was meant to help Pakistan "to reduce economic vulnerabilities and generate sustainable and balanced growth". It demanded decisive fiscal consolidation to reduce public debt (IMF, Press Release No 19/264).

Pakistan is in a vicious cycle of serious high debt servicing liabilities. It's total debt and liabilities surged to 106 % of GDP in 2020 since PM Khan took office in 2018. Domestic debt has risen by 35 % to about $ 135 billion. Its foreign reserves have been falling to a low of $ 13 billion. The fiscal problem was compounded by the Covid pandemic which hit Pakistan's economy. Its GDP contracted by 2,8 % in 2019/20. The 2020 inflation rate was extremely high in January (14,6%) and March 2020. It reduced to 8,2 % in August 2020 (State Bank of Pakistan, Inflation Monitor).

Many CPEC projects came to a halt for a few months. In March 2020, PM Khan asked China for a moratorium for interest payments on its loans, especially for the power projects in order to mitigate the economic impact

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of the Covid pandemic. He hoped that a moratorium would result in about $ 500 million savings annually. Pakistan also sought an extension for the present 10-year repayment period to 20 years from China. It remains unconfirmed whether or how much China has acceded to these requests but there was clearly a need for China to protect the core of the CPEC projects. The Chinese Government announced on June 7, 2020, that because of the pandemic, it would suspend debt repayment for 77 developing countries, among them Pakistan, under the G20 Debt Service Suspension Initiative (DSSI) from May 1 to December 1, 2020. DSSI was offered by the G20 in April 2020. But China seems to have refused to include some of its state-owned enterprises in this debt suspension agreement. Pakistan also borrowed $ 1 billion in 2020 from China to refinance a $ 6.2 Billion loan it had secured from Saudi Arabia in 2018. Pakistan also received a $ 1.4 billion "Rapid Financing Instrument" from the IMF, an Asian Development Bank (ADB) emergency Covid loan of $ 305 million in May 2020 as well as $ 500 million each from the World Bank, the Asian Infrastructure Investment Bank and the ADB in June 2020, altogether $ 4.205 billion.

For economic and political reasons, China will do all it can to prevent a financial default by Pakistan. Pakistan has borrowed a substantial amount from China in the last few years; it is estimated that it owes China between $ 22 and 30 billion, which constitutes the largest portion of its external debt Pakistan owes to one country. A dangerous debt spiral is looming. Restructuring or rolling over of these debts might soon prove not to be feasible anymore. And China might demand swapping debts with equities or having greater control over some of the CPEC projects.

Why still coal?

The Sharif government's decision to switch from oil to coal might still weigh heavy on Pakistan's emissions goals. The intention was to become independent of oil price fluctuations and to develop and use more domestic coal from the Thar coalfields. The succeeding Imran Khan government never had a chance to change the policy midway nor did it really intend to. At a time when many countries worldwide have been reducing their reliance on coal, the CPEC portfolio is heavy on coal-based infrastructure. 70 % of the 13.8 gigawatts worth of all the CPEC power plant projects are coal based. (Z. Ebrahim) Coal usage is therefore projected to rise from 5 million tonnes in 2015 to 15 million in 2020. Coal imports, mainly from South Africa and Indonesia, have more than tripled between 2015 and 2018 (TheGlobalEconomy.com) as local reserves are insufficient, unsuitable or only in the process of being developed (such as Thar Block 1 Integrated project). Coal's share in the energy mix rose to an unprecedented 25 % in 2019 (sustainable hydro, solar, wind energy production is at 25 %) and will increase. Pakistan's commitment to reduce greenhouse gases under the Paris Agreement will be harder to achieve. The international trend is turning away from coal towards more sustainable power supply. The focus on coal is also in contrast to China's newly proclaimed sustainability policy. China's President Xi recently pledged before the UN General Assembly that China's greenhouse gas emissions would peak before 2030 and that it would achieve carbon neutrality by 2060. Abroad, Chinese companies and government continue to be heavily involved in the financing, construction and running of Pakistan's coal power plants.

Most CPEC power plants are built "on a build, own, operate, transfer basis in which the plants ownership will be transferred to the Government of Pakistan after 30 years of operation" (CPEC website), the so-called BOOT model. Having these long-term contractual rights, Chinese companies collect electricity fees as Independent Producers (IPP) at prices which are guaranteed by the Pakistani government. This business model for CPEC projects gives the Chinese state run as well as private Chinese entities an optimum of investment return. Even more costly for Pakistan: the Pakistani government has issued sovereign guarantees for all CPEC power projects because of Chinese fears of delayed payments for power plant projects (E. Downs). The BOOT model, e.g., was used in the $ 1.8 billion Sahiwal Coal Power Plant which is built, owned and operated by two Chinese companies which had formed one holding company. That constellation turns out to be problematic in terms of cost transparency and accountability. It gives the Chinese owners the possibility to fix the price at which they sell electricity to the power distribution companies.

Hopes that electricity would become cheaper with an increased power supply have, so far, not yet materialized. The Pakistani National Electric Power Regulatory Authority (NEPRA) acceded to the petition of power distribution companies and announced in August 2020 another electricity price increase due to "increased fuel prices".

Security situation in Baluchistan

Chinese security concerns regarding the safety of its Baluchistan projects and its workers, especially in Gwadar, have been addressed with priority. For years, Baluchistan separatists and insurgents have been fighting the government, recently with an attack on the Karachi Stock Exchange. On top of this, CPEC projects as well as Chinese project workers have become increasingly unpopular and "became a new source of grievance among the Baluchistan population" (T. Tanner). In 2018, there had been attacks by insurgents on Chinese workers and the Chinese Consulate. The government established a Special Security Force to protect CPEC projects in Baluchistan. The Pakistani Army launched major security operations but seems to have been rather heavy-handed in its approach. Alleged extrajudicial arrests and the abduction of hundreds of people by the Army have resulted in local protests and a loss of confidence in the Pakistani army as well as the national Government.

Increased Role of the Pakistani Military

The last two years saw a substantial increase of power of the Pakistani military and army linked institutions in the implementation of CPEC projects. With Gen. Bajwa as CPEC chairman, the military won an important comeback in running civilian projects and effectively took a greater influence over the CPEC Authority and the CPEC projects. This has weakened civilian and political oversight of the country's most important development projects and financial commitments and given rise to accusations of nepotism and collusion. China has been supportive of this development as it hoped that a greater military role also meant a more efficient and expeditious execution of CPEC projects together with the Chinese companies involved.

Opposition rising

Following steep electricity price hikes, a government committee was set up in August 2019 to review the power sector and examine the costs and tariffs of 60 power plants including the role of independent power producers (IPP). In its report, submitted in April 2020, it found serious "malpractices" by IPPs such as inflated operating costs and unusually high annual profits amounting to about $ 630 million. The committee also pointed out "malpractices" at two Chinese newly built and operated coal plants (Sahiwal and Port Qasim). Criticism is being levelled at the Chinese business model of building and operating CPEC plants which makes proper oversight of the real costs of production and sale of electricity difficult. The Government has not followed up with concrete actions on the Committee report but has recently set up yet another Committee to negotiate with the IPPS over their "overcharging" in electricity tariffs.

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In September 2020 eleven opposition parties formed the "Pakistan Democratic Movement" and organised mass rallies in Karachi where leaders of major opposition parties (the children and political heirs of Benazir Bhutto and Nawar Sharif respectively) called for the ouster of PM Khan. The alliance criticised PM Khan's handling of the economy and the increased role of the military in the governance of Pakistan.

Five years after the start of CPEC, Pakistanis demand greater transparency, accountability and scrutiny of CPEC projects. The Chinese and Pakistan governments as well as the companies involved will have to move fast to prove the efficacy and legitimacy of the various projects. It is in Pakistan's and China's interests to ensure that tangible benefits of the multibillion-dollar investments reach the Pakistani population soon and that greater transparency in the operation of completed projects is achieved.

At this juncture, China cannot afford CPEC not to be a success story as it is China's most visible investment among the broader BRI scheme. China has a great interest in an economically viable and financially stable Pakistan. Pakistan's financial and economic woes, compounded by the effects of the Covid pandemic, do not leave much room for manoeuvre.

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Remarks: Opinions expressed in this contribution are those of the author.

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