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China Pakistan Economic Corridor: A Primer



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PRIME Institute Suite 714, Silver Oaks Apartments, F-10 Markaz Islamabad
research@primeinstitute.org | www.primeinstitute.org

China Pakistan Economic Corridor: A Primer

Background

The China-Pakistan Economic Corridor (CPEC) is being developed as part of the strategic partnership between the governments of China and Pakistan. In principle, understanding on building the economic corridor from Pakistani port city of Gwadar to the Western Chinese city Kashgar was developed in 2007 between China and Pakistan but it was formally announced during the visit of Prime Minister of Pakistan to China in July, 2013. CPEC is around 2,700km long within the territory of Pakistan, crossing snow-capped mountains, narrow valleys, lush green fields, sand dunes and dry hills. In addition, the corridor provides Chinese traders a link to deliver their goods to the international markets through the Gwadar Port. The \$46 billion CPEC presents a package of energy, communication and infrastructure projects, knowledge and technology cooperation, cultural exchange, and many other facets of “shared prosperity” between China and Pakistan.

Introduction

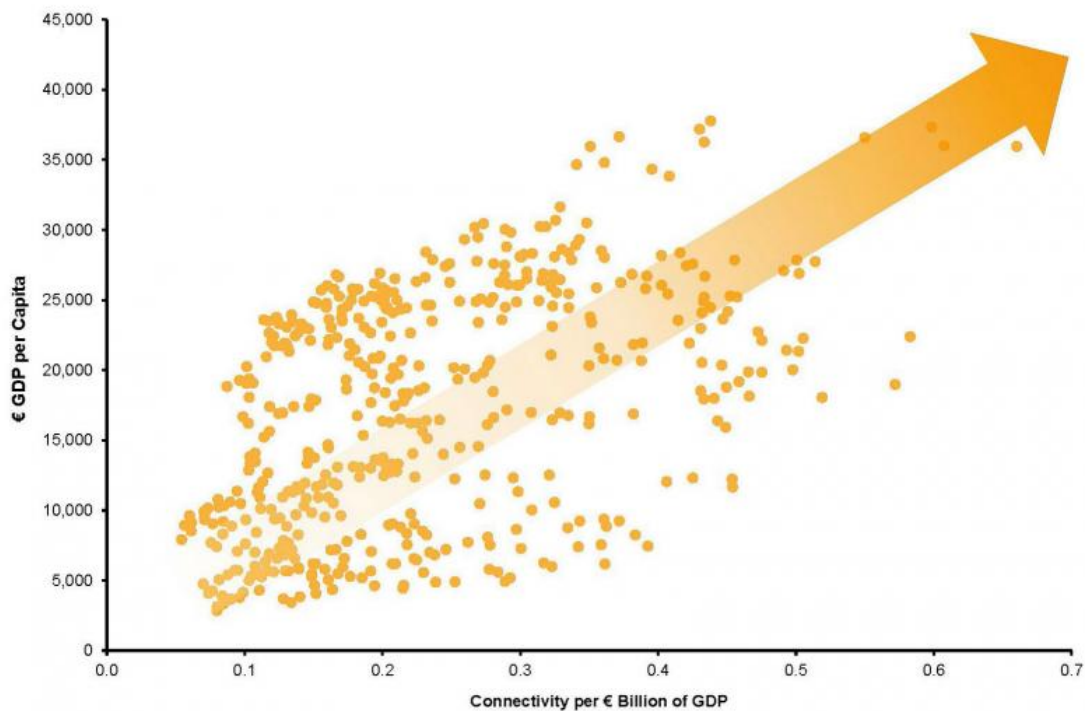
This report “China Pakistan Economic Corridor: A Primer” brings together, for the first time in Pakistan, facts, policies, perceptions and implementation status at one place about the most important business deal for the country. The report provides a broad overview of economic significance of economic corridors, identifies parameters of their success, highlights salient features of the institutional and legal framework that governs CPEC, identifies business opportunities alongside the route, highlights concerns from Pakistan’s private sector, updates on the implementation status of CPEC and suggests next steps.

The report is based on a review of available literature, background meetings with the senior government officials and representatives from business associations. PRIME Institute wishes to thank Professor Ahsan Iqbal, Federal Minister for Planning, Development & Reforms for his guidance and Major General (retd.) Zahir Shah, Project Director CPEC Coordination Cell, Dr. Faheem ul Islam, Member Private Sector Development Planning Commission, Dr. Nadeem Javaid, Chief Economist, Mr. Adil Sharif, Senior Manager Legal Private Power Infrastructure Board (PPIB), Mr. Abdul Aleem, Secretary General Overseas Investors Chamber of Commerce and Industry, Mr. Fuad Ishaq, President Khyber Pakhtunkhwa Chamber of Commerce and Industry and many other respondents for sharing their views. We also wish to thank all participants of the interactive session *China-Pak Economic Corridor: Opportunities, Challenges and Strategic Significance* held recently at the Planning Commission.

Significance of Economic Corridors

Economic corridors are considered to be the most comprehensive form of the various corridors (industrial, trade and commerce corridors, etc.) that bring together a locality's/country's potential in terms of trade, industry and investment. In the long run, economic corridors are meant to provide fast, efficient and reliable access to industrial production units and significant reduction in the transaction costs (like transportation and cost of carrying out trade). These all, in turn, serve as an attraction for investors. The basic philosophy behind development of such corridors is rooted in designing a way to connect different nodes or points of a geographical locality (like commercial nodes, border nodes, gateway nodes and interchange nodes). Economic literature and research are replete with studies that show a strong, positive link between efficient geographical connectivity and growth of income. This is demonstrated in the following graph, which depicts that better connectivity leads to better per capita income outcomes across Europe.¹

Figure 1: How Connectivity Helps Growth



These kinds of corridors have been built in almost all parts of the world with. Generally, their existence has benefitted the countries that have chosen to go ahead with these kinds of corridors. For example, the economic corridor operated in the Baltic states proved to be a good enhancer for exports and imports. Smaller states like Latvia and Estonia, which experienced considerable economic turmoil in the aftermath of the breakup of Soviet Union, have now relatively high export-to-GDP ratios of 50 percent to 70 percent plus a complex

¹ Source: World Bank, World Development Indicators databank.

export manufacturing base. Not only have economic corridors proven to be useful between countries, they have even proved useful in instances of being built within a country. The corridor between Jena and Berlin (in Germany) has helped the town of Jena regain its prominence in terms of being a world leader in optics.



“Both countries stand to gain from this arrangement, although the realized benefits would critically depend upon the relative abilities of each side to understand and capitalize on the opportunities offered.”



Factors of Success for CPEC

Economic corridors are meant to enhance trade and business, and none has worked solely on the basis of being run by the government alone. Private sector’s participation is a must, as is attracting investment towards the corridor in the long run. Therefore, it is imperative that policymakers take care of the various aspects that may hamper the efficient working of the proposed corridor. Fortunately, they have a number of studies and their conclusions to serve as a guide. Otherwise, increase in transaction costs tend to act as a detriment to the private sector’s participation.

The following is a brief guide to the kinds of problems encountered by businesses in the case of other corridors. A study carried out by ADB² came up with the following factors that negatively affected the participation of the private sector in economic corridor planned for Mekong region.

Table 1: Factors affecting private sector led participation

Serial No.	Description
1	Competition with domestic competitors
2	Competition with foreign competitors
3	Too high taxes and duties
4	Other fees and unofficial payments
5	Lack of infrastructure: roads
6	Electricity and fuel prices
7	Low productivity/efficiency
8	Telecom prices
9	Customs/Foreign trade regulations
10	Foreign currency exchange regulations

² ‘Strategy and Plan for EWEC in greater Mekong region’, ADB (2010).

A study carried out by the Brookings India³ points to the absolute necessity of having a credible infrastructure in place before gains start to accrue from building economic corridors. Once the basic infrastructure is in place, the study argues for turning attention towards 'softer' aspects of trade facilitation (customs barriers, harmonization of regulations on border crossings, etc). Long transit times at border crossings, complicated rules of official institutions involved in regulating trade, quality of freight transport and high custom rates charged at border crossings increase the transaction costs significantly.

Alstadt and Weisbrod⁴ carried out an extensive study related to the question of connectivity and successful local economic outcomes. Using 514 distinct parameters for 54 industrial sectors, they tried to find factors with statistical significance. They found that a) market size and size of local economies are significant factors, especially when it comes to attracting trade and service related industries, b) the same factors are also important for manufacturing, construction and utilities sector, but the access to efficient supply chain as well as per unit costs, c) for professional, scientific leisure and administration related businesses, access to a commercial airport is critical since their employees tend to travel more frequently, and d) intermodal freight terminal access is extremely important to industries that make use of inputs like coal. The same study gives calculation of industry wise 'sensitivity to access' measure for various industries. 50 sectors of economic activity are mentioned⁵.

According to the ADB⁶, there are critical prerequisites for any successful economic corridor: They are (i) the need to identify economic potential, without which private investment would not be forthcoming, implying a need for geographic selectivity and prioritization both across and within a given corridor; (ii) political commitment and coordination across multiple stakeholders at various levels of government, across diverse government agencies, and among countries; (iii) detailed economic and technical analyses to identify business opportunities, infrastructure needs, and policy and regulatory prerequisites; and (iv) sustained commitment over 1 decade or more.

The above are only some of the studies that deal with issues related to successful operation of an economic corridor. Since the proposed CPEC is in its earliest stages, it would be helpful for policymakers to consider the above stated aspects (and make detailed studies) regarding issues that hamper the successful functioning of an economic corridor. In this regard, a reading of the Global Competitiveness Report 2014-15 gives a good account of the state of communication infrastructure in Pakistan. In terms of infrastructure, Pakistan is ranked a lowly 119, with electricity provision coming in at a dismal 133. This will help out in identifying the major bottlenecks in improving the infrastructure.

³ 'Economic Corridors', Brookings India. <http://www.brookings.in/economic-corridors-2/>

⁴ 'The relationship of transportation access and connectivity to local economic outcomes: A statistical analysis', Brian Alstadt and Glen Wiesbrod (2012).

⁵ Ibid; Table 3, page 12.

⁶ 'A case study of the Almaty-Bishkek Corridor', ADB (2014).

The CPEC: What's in it for China?

The proposed economic corridor between China and Pakistan is also being built to achieve the goal of economic integration through enhanced communication, and the increase in trade through building the CPEC. Both countries stand to gain from this arrangement, although the realized benefits would critically depend upon the relative abilities of each side to understand and capitalize on the opportunities offered. CPEC is not the only project of this nature that China is pursuing. In fact, China is pursuing the construction of six major economic corridors to serve better links and connectivity between Asia and Europe.⁷ This is part of China's 'one belt, one road' philosophy, and CPEC is part of this plan. Aimed primarily at enhancing trade and reducing land distance travelled by China bound goods, it is also aimed at addressing the relative economic backwardness of western China. It's an inland region within China facing a tremendous cost disadvantage in terms of sending goods outside China. Xinjiang offers a clear example of this as the cargo export from Xinjiang to the rest of the world needs to go through more than 4,000 km railway across Northern China to Tianjin (located in East of China). From there, it is taken outside of China through ocean freight, resulting in a very high shipping cost. But the proposed China-Pakistan railway line from Kashgar to Gwadar will halve the distance, thus saving precious time and substantial cost for western Chinese businessmen. With the completion of the CPEC, China is expected to save an estimated \$2 billion annually through supply of oil using the shorter route from Gwadar to western China⁸. Thus not only is CPEC cost effective, but it is also aimed at integrating the relatively backward western Chinese areas with the rest of China and the world.

How Pakistan Stands to Benefit

From Pakistan's perspective, CPEC has been termed as a 'game changer'. The views of policymakers in Pakistan are aptly summed up in the following remarks given by Professor Ahsan Iqbal, Federal Minister for Planning, Development and Reforms:

"CPEC is not the name of a single route or alignment, rather it is a comprehensive package of co-operative initiatives and projects encompassing regional connectivity, information network infrastructure, energy co-operation, industries and industrial parks, agricultural development and poverty alleviation, tourism, financial co-operation as well as livelihood improvement including municipal infrastructure, education, public health and people-to-people communication which will result in thousands of new ventures and millions of jobs in every part of country".⁹

⁷ Yang Ziman, 'Six Economic Corridors to better connect Asia and Europe', China Daily.

⁸ This is an estimate based on the assumption that only 50 percent of the total Chinese oil demand will be met through this route. See Ali Salman, 'Pakistan-China Economic Corridor: A Cost-Benefit Analysis', Express Tribune, 3rd May 2015.

⁹ 'China Pakistan Economic Corridor from Geo-politics to Geo-Economics', Ahsan Iqbal, Business Recorder, 21st April 2015.

Ahsan Iqbal has also recently said that “the Chinese investment of 46 billion US dollars has changed country’s image from safe havens for terrorists to investment hub and economic activity¹⁰.” According to an independent expert, Sakib Sherani, “With a planned portfolio of projects totalling around \$45 billion, the size of the ‘investment’ in the CPEC over the next 15 years, if materialised, will equal the cumulative gross foreign direct investment inflows into Pakistan since 1970.”

Our background interviews with the top government functionaries suggest that the government is still pondering over ways to benefit from this opportunity. In the words of Project Director of CPEC Coordination Cell, “We are facing a huge challenge in terms of guiding our people on how to really benefit optimally from CPEC because Chinese are really focused and committed to build it anyway.¹¹”

The Board of Investment envisions that development of Special Economic Zones (SEZ) alongside the infrastructure corridor will ensure the economic viability and vibrancy of the Corridor. SEZs will target specific products and services while analyzing the availability of local raw material and other vital factors. This initiative will lead to efficient transportation system that will have a very positive multiplier effect such as better accessibility to the markets, and additional investment, job creations, technology transfer, generation of economic activity, social and economic development. Moreover, Provincial governments will construct the approach roads up to zero points of the SEZ.

At the moment, no detailed study has been undertaken to estimate number of jobs to be created within Pakistan as a result of CPEC. However, a PC-1 has been approved whereby “at least 10,000 security jobs will be created in order to provide security to Chinese investors and workers coming to Pakistan”.

Infrastructure Investments

CPEC is well in line with Pakistan government’s earlier plan of establishing a National Trade Corridor (NTC), proposed in 2005, with the public sector financing of around \$9 billion. Under which it was proposed to integrate the whole of Pakistan’s economic potential (rural plus urban) in the form of better connectivity/linkages through a better road infrastructure. The rationale behind initiating this project is the realization that a lack of infrastructure and weak linkages between the nation’s various geographical parts are costing the economy a substantial amount of money. For example, as per the Economic Survey 2013-14, the poor state of transport infrastructure costs Pakistan an estimated 5 percent of its GDP per year. Therefore, it is imperative that such waste should be curtailed. The improvement in the communication infrastructure (quality of transport, time taken to

¹⁰ Seminar at Planning Commission. Official press release, available at: <http://www.pc.gov.pk/?p=4575>.

¹¹ Interview with Major General (retd.) Zahir Shah, Project Director CPEC Coordination Cell, Planning Commission, dated 31st August 2015

reach destination, lower transaction cost barriers, etc.) could see Pakistan's trade improving by more than a \$100 billion within a decade¹².

In short, CPEC is of tremendous importance to Pakistan as far as its economic fortunes are concerned. While Pakistani policymakers intend to develop CPEC primarily for enhancing international trade, the development of NTC is aimed at efficiently connecting Pakistan's different regions. Combined, these two could give trade, commerce, industry and services a tremendous boost.

Indicating opportunities in the power infrastructure, Dr. Faheem ul Islam, Member Private Sector Development, believes that there are a lot of opportunities for private sector infrastructure in transmission and distribution of power (energy) along the CPEC route along with the development of industrial parks. The Pakistani suppliers can collaborate with the Chinese energy producing companies in transmission and distribution of power.

He also highlighted that construction of new airports along economic nodes of CPEC will be an attractive opportunity for private investors. Moreover, equal treatment will be given to local and private investors along with a liberal visa policy. In particular, he believes that industrial and investment clusters can be formed in the areas of Agriculture and Mining¹³.

The Chinese companies involved in Pakistan's power sector projects under CPEC are as follows¹⁴:

1. S.K Hydro private Ltd. (working on Sukki Kinari Hydel project)
2. China International Water and Electric Company (Kohala Hydropower project)
3. Shanghai Electric (1320 MW Thar coal based power project)
4. Sino-hydro Resource Limited (1320 MW Port Qasim imported coal based power project)
5. China Machinery Engineering Cooperation (300 MW Pind dadan khan coal power project)
6. Huaneng Shandong Ruyi (1320 MW Sahiwal imported coal based power project)

Trade and Business Prospects

To analyze the opportunities offered to the Pakistani business community, consider first the statistics related to trade. Pakistan's total share in world exports stands at a dismal 0.13 percent, and its share in global trade was 0.14 percent in 2012-13 (it was 0.21 percent in 1999). In FY 2013-14, Pakistan's exports to China were valued at \$2.6 billion, which is a negligible 0.13 percent of China's total imports (estimated at \$1,996 billion at the same time).

¹² Economic Survey 2009-10, Government of Pakistan.

¹³ Dr. Faheem ul Islam, Member Private Sector Development, Planning Commission. Interview on 8th September 2015.

¹⁴ http://www.ppib.gov.pk/N_upcoming_ipps.htm

Clearly, there is a lot of room for improvement and enhancement of exports. China is now the second largest importer in the world, implying that Pakistan has a golden chance in terms of utilizing CPEC to enhance its share in a market where the cumulative demand is growing at more than 5 percent per annum.¹⁵ The following tables will make this even clearer.

Table 2: Pakistan's share in total Chinese imports

Year	Chinese Imports (\$b)	Pakistan's exports to China (\$b)	% of Chinese imports
2004	561	1.15	0.20
2005	660	1.84	0.28
2006	791	2.74	0.35
2007	956	1.1	0.12
2008	1132	1	0.09
2009	1005	1.2	0.12
2010	1396	1.43	0.10
2011	1743	1.67	0.10
2012	1818	2.62	0.14
2013	1950	2.65	0.14
2014	1966	2.93	0.15

Source: Various Economic Survey's, Pak-China Business Council, and TDAP stats



“CPEC is welcomed, all provinces of Pakistan will get benefits of it, it will boost construction activities, development of industrial estates, employment of labor, and will change the fate of Pakistan.”

Fuad Ishaq, President Khyber Pakhtunkhwa Chamber of Commerce & Industry



Table 2 is a clear indication of the fact that while Pakistan’s exports to China have more than doubled in a decade, the relative share of Pakistan’s exports in China’s imports have fallen by 25%; the column on the right depicts Pakistan’s percentage share in China’s imports. This

¹⁵ Authors’ calculation, based on the Table 2 presented in this section.

is despite the fact that China lies in its vicinity, and that the two countries have enjoyed the friendliest of relations. Since China's overall demand for goods is the highest in the world, and goods from Pakistan can travel to China at lower freight cost, there is ample scope for Pakistan to capitalize on opportunity.

Tables 3 and 4 offer further proof of the fact that Pakistan and Pakistani businessmen are missing out on a golden opportunity.

Category	Value (\$b)	% of total imports	PAK's exports (\$b)	% of Chinese imports
Electronic Equipment	425.1	21.7		0
Oil	316.7	16.1		0
Machines, Engines, Pumps	179.6	9.2		0
Ores, slag and ash	136	6.9	0.12	0.09
Medical, Technical Equipment	105.8	5.4		0
Vehicles	89.5	4.6		0
Plastics	75.2	3.8	0.04	0.06
Organic Chemicals	60.6	3.1		0
Copper	47.5	2.4	0.04	0.08
Oil Seed	45.9	2.3		

Table 3: Top 10 Chinese Imports (2014), their value and Pakistan's share

Source: WTO, Chinese Trade Development Authority, UNCTAD and WB statistics

Table 4: Top 10 Pakistani Exports to China, and their share of Chinese imports

Category	Value (\$b)	Total Chinese imports (\$b)	% of Chinese imports
Cotton	1.9	38	5
Cereals	0.14	5	2.8
Ores, slag and Ash	0.12	136	0.09
Salt, sulphur, stone and cement	0.063	3.7	1.7
Raw hides (excluding furskins)	0.057	2.6	2.2
Plastics	0.043	75.2	0.06
Food waste, animal fodder	0.033	2	1.65
Copper	0.036	47.5	0.08
Fish	0.035	1.7	2.06
Gum, Resin	0.029		

Source: USDA, WTO, WB and Pak-China Business Council

Table 3 and Table 4 are a reflection of what Pakistan is missing out in terms of potential for exports. Table 3 demonstrates that of the top 10 Chinese imports, only 3 have a Pakistani share which is dismal. Table 4 shows that Pakistan's top 10 exports to China have failed to capture any substantial portion of the total Chinese imports in those categories. This all again points to the fact that Pakistan and Pakistani businessmen have been unable to take advantage of this tremendous development in their immediate neighbourhood.

According to a recent report by the Pakistan Business Council, while China managed to export along 57% of the lines in which it had a preference under the FTA, Pakistan's utilization was a mere 5% along lines in which Pakistan had managed to 'negotiate' concessions. Finally, the concessions offered by China to Pakistan had more or less been negated due to better or equal concessions offered by China to its other trading partners, some of whom are Pakistan's competitors¹⁶.

The tables presented above clearly point out not only the failures of Pakistani goods to penetrate this large market, but they also point to tremendous possibilities for the future. The initiation of CPEC can serve to enhance these possibilities. With the completion of this project, goods would be even easier to transport from land route to China. Also, it will be helpful for businessmen to keep an eye on the dynamics of demand in China, and which products have the fastest growing demand. The following table should give a fair idea of what to look for.



Pakistan Agricultural Research Centre and the National Agricultural Research Centre have proposed eight 'agro-business' centers along the CPEC route. They have also pointed out that at least twenty different commodities are grown along the proposed corridors, which have wide export potential.



¹⁶ Second Review of Phase I of the Pakistan-China FTA and Recommendations for Phase II Negotiations, The Pakistan Business Council, March 2015

Table 5: Fastest Growing Chinese Imports since 2010¹⁷

Category	2014 Value (\$b)	% change since 2010
Collector Items, Arts, Antiques	0.613	228.1
Cereals	6.2	311.3
Gems, Precious Metals	41.9	286.3
Umbrella's, Walking sticks	0.22	257.9
Dairy, eggs and Honey	6.5	224.4
Live Animals	0.835	210.2
Tobacco	2.1	164.7
Meat	5.8	162.5
Knit or Crotchet clothing	2.1	152.6
Clothing	3.6	150.6
Meat and seafood preparations	0.249	148.6
Pharmaceuticals	17.7	145.2
Fruits and Nuts	5.1	140.1
Cereal, Milk preparations	2.8	130.4
Aircraft, spacecraft	28.5	129.9
Coffee, tea and spices	0.342	128.3
Perfumes and Cosmetics	3.4	124.6
Milling products	0.963	113.4
Footwear	2.3	105.4
Toys, Games	2.1	103
Wood	22.8	102
Explosives, Pyrotechnics	150	102
Furskins and Artificial fur	1.3	102.1

In the above stated sectors/industries, there are some in which Pakistan already has a strong base. For example, clothing, pharmaceuticals and Tobacco industries are well established in Pakistan. If products from these Pakistani industries are not making it to the Chinese market, there must be a reason for it. Therefore, what is needed is a deeper analysis of the potential opportunities and what steps are required to take advantage of this situation. Some Pakistani institutions have in fact been alive to this need and have carried out their work in this regard. For example, Pakistan Agricultural Research Centre and the National Agricultural Research Centre have proposed eight 'agro-business' centres along the CPEC route. They have also pointed out that at least twenty different commodities are grown

¹⁷ Of these, Pakistan only figures in the 'cereals' category. Its exports are hardly 0.5 percent of the total cereals imported by China.

along the proposed corridors, which have wide export potential¹⁸. The growth in exports of these agro-based commodities, in turn, will spur more businesses in the area in the form of freight, scientific research centres, agro-farms and agricultural technology suppliers, etc.

Concerns of Pakistan's Private Sector

Some of our background interviews with the government officials indicate a strategic tilt in Pakistan's case. As noted by Sakib Sherani, 'If, despite the odds, the CPEC can be structured and operationalised as a truly networked economic corridor, its benefits for Pakistan will no doubt be enormous. If, however, it ends up primarily as a bilateral strategic project, the economic costs could be substantial¹⁹.'

The Pakistani private sector is also showing some concerns over how the government has handled the CPEC so far. In his interview, Mr. Abdul Aleem, Secretary General, Overseas Investors Chamber of Commerce & Industry (OICCI), said that CPEC is a golden opportunity but mishandling this opportunity will be a historical tragedy. He expressed that, "to materialize this opportunity, various government departments and ministries, as well as provincial governments need to synchronize their efforts." More importantly, he opined that as an apex body representing international investors in the country, OICCI has not been consulted on CPEC, though it fully endorses the project due to its national importance²⁰.

Furthermore, Article 9 of the agreement obliges Pakistan to comply with Chinese regulations. The Article 9 reads as:

"The Pakistani Party agrees that Chinese standards will be adopted in designing and building the Chinese company-invested projects subject to their prior approval by the Pakistani regulator and the power purchaser."

These obligations to the Chinese regulations arise a concern, that what if the Chinese technology is itself not in compliance with the international standards. For instance, a major European manufacturer already based in Pakistan approached PTV to introduce new European technology in digitalising the PTV transmission instead of using Digital Terrestrial Multimedia Broadcast (DTMB), a China based technology, for the purpose. However, Pakistan Television refused the offer in order to comply with the Chinese regulations.

¹⁸ There are different accounts.

http://epaper.dawn.com/DetailImage.php?StoryImage=10_08_2015_604_001
<http://www.brecorder.com/business-and-economy/189:pakistan/1220354:8-sites-for-setting-up-agro-business-centres-along-cpec-identified/?date=2015-08-25>

¹⁹ Sakib Sherani, "Evaluating CPEC" Published on May 1, 2015 in Dawn, <http://www.dawn.com/news/1179169>

²⁰ Abdul Aleem, Secretary General, Overseas Investors Chamber of Commerce & Industry, Telephonic Interview, 2nd September 2015.

On the other hand, there are views inside the government that the Pakistani private sector is itself not on board and well prepared to avail this historical opportunity²¹.

CPEC also brings in a major concern of regional equity as its Eastern Corridor is well developed with industrial parks and industries already in operation, therefore government must ensure on bringing equal potential of the western corridor. According to Naeem ul Zafar, Member Social Sector, Planning Commission, a large portion of the Chinese investment will be invested in Baluchistan which will lead to reduce the regional disparity and opportunities to improve human resource and infrastructure of the western corridor. Furthermore, the deprived districts of Punjab, Sindh, and KP along the CPEC route are most likely to receive positive impacts and the benefits of improved transport and communication system and better connectivity to and from other regions of the country.²²

Legal, Financing and Institutional Framework of CPEC

The Ministry of Planning, Development & Reforms (MPD&R) is the focal Ministry for this engagement whereas its counterpart in China is National Development and Reform Commission (NDRC). The Government of the People's Republic of China and the Government of Pakistan have signed MoUs under CPEC. MoU enables the Governments to cooperate in the planning and development of CPEC and facilitate and intensify economic activity along the Corridor²³.

The progress on CPEC is being monitored by a Joint Cooperation Committee in which representatives from both governments are included. The projects under CPEC are divided into five distinct themes which are looked after by separate working groups:

1. Transportation
2. Energy
3. Infrastructure
4. Gwadar and
5. Long-term Planning

In addition, a sixth working group is being formed on "Investment & Industry Cooperation". The working groups will focus on public-private partnerships in these areas and all the projects so far are in their planning phase.

Almost 75% of the planned \$46 billion dollars is for the energy sector, which is entirely in the Independent Power Producers (IPP) mode. In a recent interview, the Planning Minister

²¹ Dr. Faheem ul Islam, Member Private Sector Development, Planning Commission. Interview on 8th September 2015.

²² See Annex-IV

²³ Ministry of Planning, Development and Reforms, <http://www.pc.gov.pk/>, accessed on 8th September 2015.

has also shared that 75% of the planned \$46 billion investment will be in the energy sector through the IPP mode²⁴. All IPPs enjoy sovereign guarantee in Pakistan.

The energy projects under CPEC are protected under the Agreement on the China-Pakistan Economic Corridor Energy Project Cooperation, signed by two governments on 8th November 2014. The agreement has 15 articles; it is valid for six years, and is extendable by five subsequent years and can be annulled mutually. The agreement is drawn on this condition “following the market-based principles of openness, equality and mutual benefit to develop related energy projects²⁵”. However, Article 5 of this agreement provides a special clause for the Chinese energy investors. The relevant article reads as:

“The Pakistani Party agrees that a revolving account shall be opened within 30 days of



*Article 4 of Agreement on the China-Pakistan Economic Corridor
Energy Project:*

Pakistani Party agrees to offer the most preferable conditions in terms of taxation, permit, shipping, rail way transportation, warehouses and ports, status of natural and legal person during whole process of implementing the energy projects under this Agreement, ensuring that such preferable conditions given to Chinese investors will not be inferior to those to any third country, under the applicable power policies.



commercial operation of the respective project , into which the money no less than the 22 percent of the monthly payments for the respective power project under this Agreement shall be deposited to provide cover for the shortfall in power bill recoveries from the date of power generation of the said projects Agreement, subject to the condition that the additional direct or indirect expenses incurred in maintaining this revolving account would be compensated by the power producers through a discount arrangement to be mutually agreed. The Pakistani Party affirms its commitment to follow its policy of selective privatization of distribution companies on a conditional basis that power losses would be reduced in a gradual manner.”

The applicable policy framework of the Private Power Infrastructure Board does not provide a similar clause to other IPPs. It may be mentioned that this default in the payment is the primary reason for the circular debt that accumulates very frequently to hundreds of billions

²⁴ The News, 25th August 2015. <http://www.thenews.com.pk/Todays-News-6-336101-We-are-moving-forward-with-a-vision-says-Ahsan>

²⁵ See Page 1 in Agreement on the China-Pakistan Economic Corridor Energy Project Cooperation between the Government of People’s Republic of China and the Government of the Islamic Republic of Pakistan.

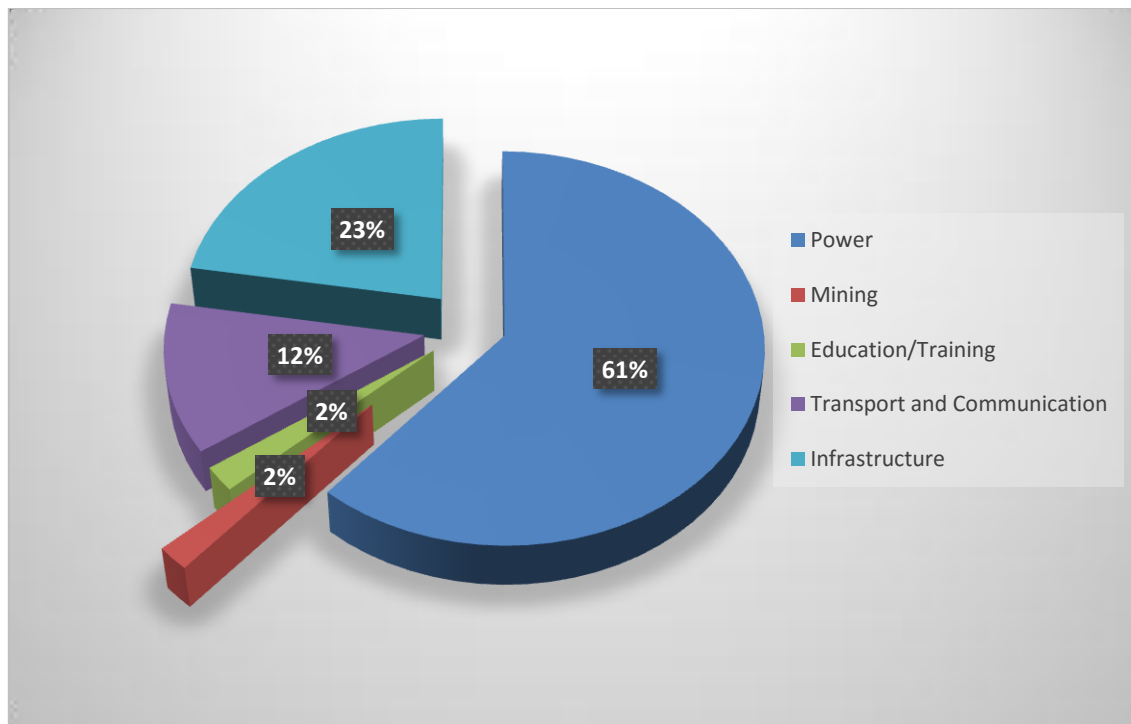
of rupees. This Article 5 was approved in a meeting of the Economic Coordination Committee held on 19th March 2015. This is somewhat contradictory to what the Chinese Ambassador said in a seminar on CPEC recently: “The construction of CPEC must follow the rules of market competition to ensure transparency and legitimacy²⁶.” To counter this argument of special treatment, the Planning Minister reiterates his special sentiments for the Chinese business firms for reposing confidence in Pakistan at the time, where other international investors have shied away due to security related perceptions.

Other than energy, about \$11.5 billion will be invested in the infrastructure projects, primarily in the form of the Western alignment, express ways and Gwadar Airport and several other projects. This will be in the form of Chinese government to government loan on commercial and concessionary terms.

Implementation Status of CPEC

CPEC project is divided in four phases, namely; Early Harvest (2017-18), Short term Completion (2020), Medium Term (2025) and Long-term (2030). Table 6 shows the summary of these planned investments as per the Agreement on the China-Pakistan Economic Corridor Energy Project Cooperation²⁷. Following figure also portrays an overall classification.

Figure 2: CPEC Investment- An Overview



²⁶ Sun Weidong, Ambassador Extraordinary and Plenipotentiary of the People's Republic of China to the Islamic Republic of Pakistan, Seminar at Planning Commission on 9th September, 2015.

²⁷ Agreement on the China-Pakistan Economic Corridor Energy Project Cooperation between the Government of People’s Republic of China and the Government of the Islamic Republic of Pakistan signed on 8th November, 2014.

Table 6: China Pakistan Economic Corridor- Summary of Investments

Project Name	Type	Classification	Completion date	Est. Cost (\$ billion)
Jetty and infrastructure at Gaddani	Early harvest	Infrastructure	Quarter 4, 2017	1.2
10*660 MW coal-based power plants at Gaddani	same as above	Power	Quarter 4, 2017	9.2
Power evacuation from Gaddani to National grid	same as above	Power	Quarter 4, 2017	3
2*660 MW coal-based power plants at Port Qasim	same as above	Power	Quarter 4, 2017	1.8
3.5 MT/A Thar coal mining project, Block-II SECMC	same as above	Mining	Sep-17	0.9
2*330 MW Thar coal power plants	same as above	Power	Sep-17	0.9
1100 MW Kohala Hydropower	same as above	Power	Mar-19	2.3
720 MW Karot Hydropower	same as above	Power	2018 or 2019	1.4
873 MW Sukki Kanari Hydropower	same as above	Power	2018 or 2019	1.08
100 MW wind power project block II	same as above	Power	Oct-16	0.15
UEPL 100 MW Wind	same as above	Power	Mar-16	0.15
2*660 MW coal-based power plants at Sahiwal	same as above	Power	Mar-17	1.6
2*660 MW coal-based power plants at Sheikhpura	same as above	Power		
100 MW Solar power, Bahawalpur	same as above	Power	Dec-14	0.15
Karakoram highway Phase-II, Riakot-Islamabad	same as above	infrastructure	Dec-17	3.79
Karachi-Lahore motorway(Multan to Sukkur)	same as above	infrastructure	Dec-17	2.46
Rehabilitation of Karachi-Lahore-Peshawar railway track	same as above	transport	Dec-17	3.6
Havelian dry port construction	same as above	Infrastructure	Dec-17	0.4
Gwadar East bay expressway construction	same as above	infrastructure	Sep-16	0.12
Pak-China technical and vocational institute at Gwadar	same as above	Training/education	Jun-16	0.94
Breakwater construction, Gwadar	same as above	Infrastructure	Apr-16	0.13
Dredging and berthing of channels and areas	same as above	Infrastructure	Jan-16	0.28
Infrastructure development for EPZA & GEIDA, Gwadar	same as above	Infrastructure	Jun-17	0.34
Fresh water facility and supply development, Gwadar	same as above	Infrastructure	Jun-17	1.3
China-Pak friendship hospital, Gwadar	same as above	Infrastructure	Jun-17	0.01
Gwadar International Airport	same as above	Infrastructure	Jun-17	0.23
Orange Line Metro train, Lahore	same as above	transport	Sep-16	1.6
China-Pak optical fibre cable	same as above	communication	2017	0.44
2*660 MW coal-based power plants at R.Y Khan	Prioritized	power		1.6
2*660 MW coal-based power plants at Sahiwal	Prioritized	power		1.6
2*660 MW coal-based power plants at Muzaffargarh	Prioritized	power		1.6
6.6 MT/A SSRL Thar coal mining project	Prioritized	power		1.2
50 MW Sunec Wind Power plant	Prioritized	power		0.14
50 MW Sachal Wind Power plant	Prioritized	power		0.13
50 MW Dawood Wind Power plant	Prioritized	power		0.13
Free Trade Zone, Gwadar	Prioritized	Infrastructure		

DTMB Pilot Project, Murree	Prioritized	Transport	
Total			45.87

Source: Planning Commission

The Agreement also envisions a classification in terms of Prioritized Projects and Actively Promoted Projects. This is shown in the Annex-II.

A new company by the name of Silk Road Fund Co. was established in December 2014 by the Chinese government to provide financing for investment in CPEC projects. It has already agreed to finance the 720 MW Karot hydropower project, and agreement has already been signed between China's Three Gorges Corporation and Private Power and Infrastructure Board (PPIB).

As per the Board of Investment, ground breaking of following power projects has been done by Prime Minister Muhammad Nawaz Sharif and President Xi Jinping.

1. Karot 720 MW Hydropower project
2. Dawood 50 MW Wind-power project
3. Sachal 50 MW Wind-power project
4. Zonergy 900 MW solar project
5. Jhimpir 100 MW Wind-power project

As a result of other allied agreements, various other steps have been taken. For example, FM 98 Dosti Channel studio PBC-CRI, Islamabad has been inaugurated. Similarly, Lahore branch of Industrial and Commercial Bank of China has been opened.

From the infrastructure projects, in 2015-16, PC-1 of these projects have been approved by the government, which are primarily financed by the Chinese with a minor contribution from GoP to the tune of 10%²⁸.

1. Karakorum Highway (Havelian to Thakot)
2. Karachi-Lahore Motorway (Multan to Sukkur)
3. Gwadar port East Bay Expressway Project
4. Gwadar international airport (now converted into Chinese grant)

Pakistan government has pledged to develop three sub-corridors of its own in alignment with the CPEC. These are Western corridor, Eastern corridor and Central corridor, or alignments as shown in the map at the Annexure-I. As per the understanding reached between both the governments, the eastern corridor will be built first. The rationale behind doing so is based on the ease of doing business and lower transaction costs²⁹. A detailed map of the planned projects along the three proposed routes is given at Annexure-II.

²⁸ Planning Commission terms these PC-1 as classified.

²⁹ 'China-Pakistan Economic Corridor: Lines of Development, not Lines of Divide', Shahbaz Rana, Express Tribune, 17th May 2015.

Next Steps

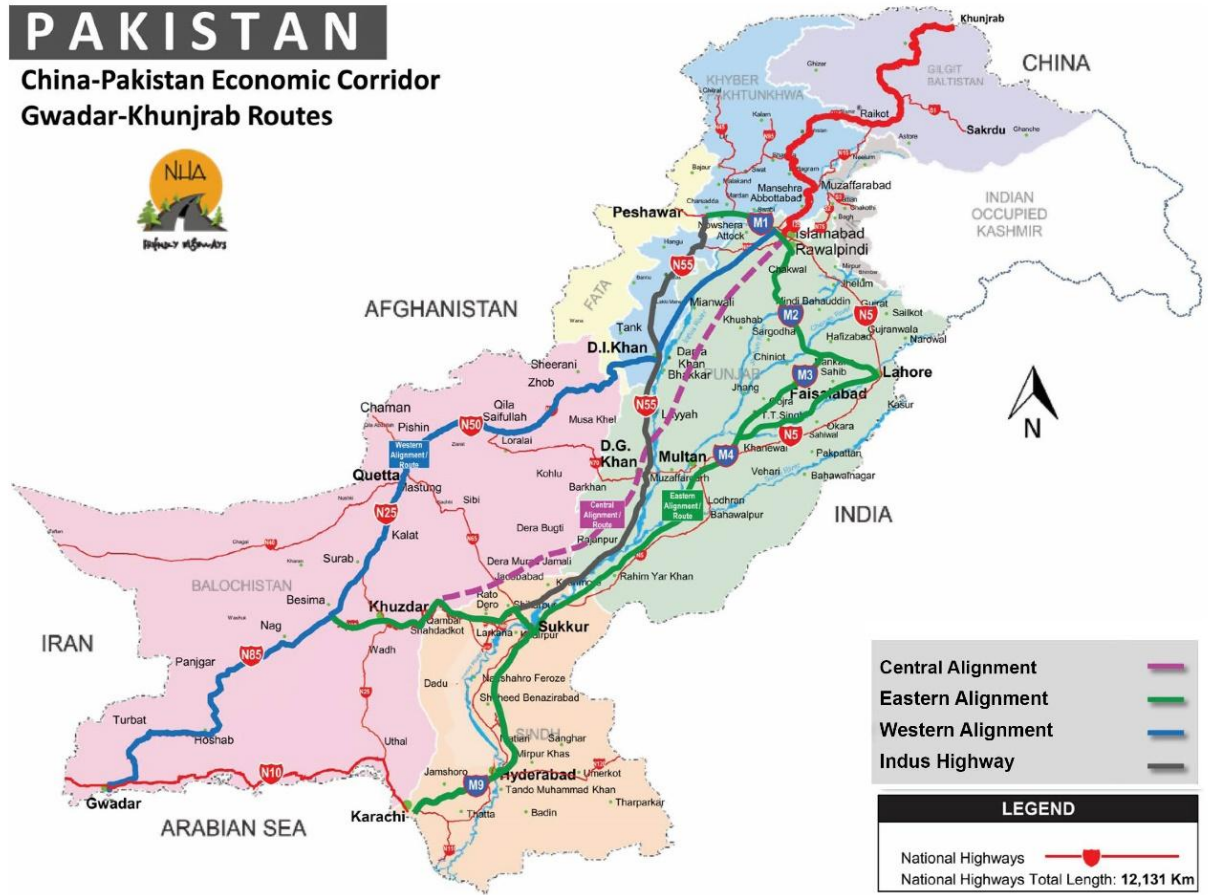
1. Planning Commission should immediately initiate studies on the business aspects of CPEC while preparing investment feasibilities at project level in consultation with relevant chamber of commerce.
2. The Ministry of Commerce may re-engage with the Chinese counterpart agencies during negotiations on the second phase of FTA between China and Pakistan in the view of enhanced openings offered by CPEC. An important consideration in planning and executing the CPEC should be the effect on Pakistan's exports. Pakistan may also consider opening up its imports to other countries at the same level to bring more competition in the "free" imports.
3. Government needs to share information (except confidential) about CPEC with business associations and business community to arouse confidence. In particular, detailed data on CPEC routes need to be released and disseminated in order to encourage and engage the private sector investors.
4. Government needs to engage the private sector of Pakistan by making them aware of the upcoming human resource gap and by training of the required skills sets in different technical institutions so that people can fully benefit from the opportunities likely to emerge as a result of construction of CPEC.
5. The Planning Commission may immediately formulate a framework for private sector participation in CPEC projects. The views of businessmen and industrialists regarding the proposed rules and regulations for private sector's participation should be sought in order to forge effective public-private partnerships.
6. Government may also address the concerns regarding practise of fair market and competition rules because the investment might be tied up with some conditions and rules falling off the international standards and practices.
7. MoWP/PPIB may undertake a risk assessment study to estimate the additional load requirements in our transmission & distribution system failing which circular debt for Chinese IPPs may appear or worse, government liabilities due to protection clause may increase.

Conclusion

There is little doubt that the proposed CPEC constitutes a game changer for Pakistan. But it is also equally important to realize that for taking optimum advantage of the CPEC, there needs to be a comprehensive assessment of what will likely make it a success. As stated above, Pakistan has a golden opportunity to cash in on the fact that the world's second largest importer is in its neighbour. Pakistan can regain its trade deficit with the post FTA China by judicious use of resources and meticulous study of business opportunities along with the development of the CPEC. This study has argued that, among other things, one critical component in the form of engaging the private sector is missing from the equation. The private sector participation is also necessary because in its absence, government will then have to take recourse to using its resources for plugging in the investment gaps for a government that is already stressed in terms of financial resources.

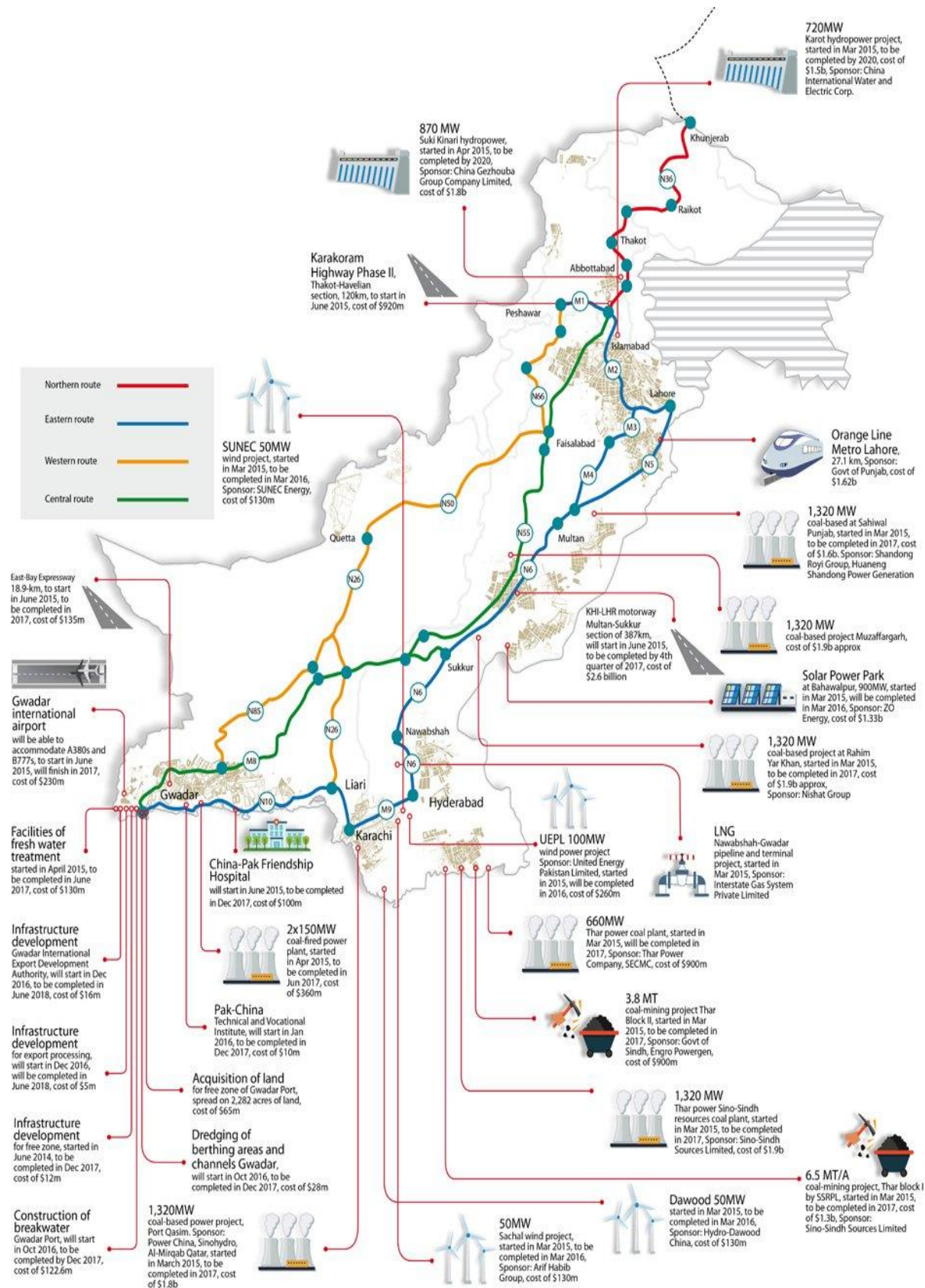
Assuming that everything goes according to the plan, there is little doubt that the potential impact of CPEC on stimulating Pakistan's economic activity is likely going to be substantial. The real question, though, is not the projected impact but how really to take advantage of this golden opportunity and to make the business community an active participant. Pakistan needs to realize the potential for trade enhancement (and thus greater exports) through a deeper analysis of where its comparative advantage in trade lies. Not only it will help in achieving higher export numbers, but it will also bring value addition.

Annexure-I: CPEC Routes



Source: Planning Commission

Annexure-II: CPEC Investment Map



Source: http://www.chinadaily.com.cn/business/2015-05/29/content_20858327.htm

Annex-III: List of Prioritized and Actively Promoted Projects

Prioritized Projects		MW
1	2x660 MW Coal-fired Power Plants at Port Qasim Karachi	1320
2	Suki-Kinari Hydropower Station, Naran, Khyber Pakhtunkhwa	870
3	Sahiwal (2x660MW) Coal-fired Power Plants	1320
4	Engro-Thar (2x330MW) Coal-fired Power Plants & Surface mine in Block II of Thar Coal Field, 3.8 million tons/year	660
5	Hydro-China Dawood 50MW Wind Farm (Gharo, Thatta)	50
6	Gwadar Coal Power Project	300
7	Muzaffargarh (2*660 MW) Coal-fired Power Project	1320
8	Quaid-e-Azam 1000MW Solar Park (Bahawalpur)	1000
9	UEP 100MW Wind Farm (Jhampir, Thatta)	100
10	Sachal 50MW Wind Farm (Jhampir, Thatta)	50
11	China-Sunec 50MW Wind Farm (Jhampir, Thatta)	50
12	Rahimyar Khan (2*660MW) Coal Power Project	1320
13	SSRL Thar Coal Block - I, 6.5 mtpa & CPIH Mine Mouth Power Plant (2*660)MW	1320
14	Karot Hydropower Station	720
Total Capacity		10,400
Actively Promoted Projects		MW
1	Gaddani Project at District Lasbela, Balochistan ³⁰	
i	4*660 MW	2640
ii	Jetty + Infrastructure	
iii	Transmission Line 1 + 2	
2	Chichoki Mallian 525MW Power Plant	525
3	Kohala Hydel Project, AJK	1100
4	Wind Farms 2*50 (Jhampir, Thatta)	100
5	HUBCO (1*660MW) coal power plant	660
6	Salt range Mine Mouth Power Project including mining	300
7	Thar mine mouth Coal fired Power plant by Oracle (2*660MW)	1320
Total Capacity		6645

³⁰ Our discussions with government officials indicate that the future of Gaddani Project is uncertain.

Annexure-IV: Less Developed Districts of Pakistan and China-Pakistan Economic Corridor Route

S. No	Deprived Districts of PUNJAB	Proximity of CPEC Route	Location of CPEC Route	Remarks
1	Layyah	Long Term Alignment	0 Km	Passing Through the District, Most Significant Positive Impact
2	Lodhran	Eastern Alignment	0 Km	Passing Through the District, Most Significant Positive Impact
3	Muzzafargarh	Eastern Alignment	1-25 Km	Significant Positive Impact
4	Rajanpur	Long Term Alignment	0 Km	Passing Through the District, Most Significant Positive Impact
5	Rajanpur	Central Alignment	0 Km	Passing Through the District, Most Significant Positive Impact
Deprived Districts of SINDH				
6	Dadu	Eastern Alignment	1-25 Km	Significant Positive Impact
7	Badin	Eastern Alignment	25-50 Km	Moderate Positive Impact
8	Jacobabad	Central Alignment	1-25 Km	Significant Positive Impact
9	Kamber	Eastern Alignment	0 Km	Passing Through the District, Most Significant Positive Impact
10	Kashmore	Central Alignment	0 Km	Passing Through the District, Significant Positive Impact
11	Sanghar	Eastern Alignment	1-25 Km	Significant Positive Impact
12	Umerkot	Eastern Alignment	50- 200 km	Less Impact
13	Tharparkar	Eastern Alignment	50- 200 km	Less Impact
Deprived Districts of KHYBER PUKHTUN-KHWA				
14	Batagram	Northern Alignment	0 Km	Passing Through the District, Most Significant Positive Impact
15	Buner (Daggar)	Eastern Alignment	1-25 Km	Significant Positive Impact
16	Hangu	Central Alignment	1-25 Km	Significant Positive Impact
17	Karak	Central Alignment	0 Km	Passing Through the District, Most Significant Positive Impact
18	Kohistan	Northern Alignment	0 Km	Passing Through the District, Most Significant Positive Impact
19	Shangla	Northern Alignment	0 Km	Passing Through the District, Most Significant Positive Impact
20	Tank	Central Alignment	0 Km	Passing Through the District, Most Significant Positive Impact
21	Upper Dir	Northern Alignment	50-200 km	Less Impact
Deprived Districts of BALOCHISTAN				
22	Jaffarabad	Long Term Alignment	0 Km	Passing Through the District, Most Significant Positive Impact
23	Kharan	Western Alignment	0 Km	Passing Through the District, Most Significant Positive Impact
24	Awaran	Makran Coastal Highway	0 Km	Passing Through the District, Most Significant Positive Impact
25	Barkhan	Long Term Alignment	25-50 Km	Moderate Positive Impact
26	Bolan	Western Alignment	25-50 Km	Moderate Positive Impact
27	Khuzdar	Eastern Alignment	0 Km	Passing Through the District, Most Significant Positive Impact
28	Qila Abdullah	Western Alignment	25-50 Km	Moderate Positive Impact
29	Qila Saifullah	Western Alignment	0 Km	Passing Through the District, Most Significant Positive Impact

30	Jhal Magsi	Long Term Alignment	0 Km	Passing Through the District, Most Significant Positive Impact
31	Jhal Magsi	Eastern Alignment	0 Km	Passing Through the District, Most Significant Positive Impact
32	Lasbela	Makran Coastal Highway	0 Km	Passing Through the District, Most Significant Positive Impact
33	Loralai	Western Alignment	25-50 Km	Moderate Positive Impact
34	Mushkhal	Western Alignment	1-25 Km	Significant Positive Impact
35	Naseerabad	Long Term Alignment	0 Km	Passing Through the District, Most Significant Positive Impact
36	Kalat	Western Alignment	0 Km	Passing Through the District, Most Significant Positive Impact
37	Gwadar	Western Alignment	0 Km	Passing Through the District, Most Significant Positive Impact
38	Gwadar	Coastal Highway	0 Km	Passing Through the District, Most Significant Positive Impact
39	Kech	Western Alignment	0 Km	Passing Through the District, Most Significant Positive Impact
40	Nushki	Western Alignment	50-200 km	Less Impact
41	Mustung	Western Alignment	0 Km	Passing Through the District, Most Significant Positive Impact
42	Dera Bughti	Long Term Alignment	0 Km	Passing Through the District, Most Significant Positive Impact
43	Sibbi	Western Alignment	50-200 km	Less Impact
44	Ziarat	Western Alignment	1-25 Km	Significant Positive Impact
45	Pishin	Western Alignment	0 Km	Passing Through the District, Most Significant Positive Impact
46	Panjgur	Western Alignment	0 Km	Passing Through the District, Most Significant Positive Impact
47	Zhob	Western Alignment	0 Km	Passing Through the District, Most Significant Positive Impact
48	Chagai	Western Alignment	50-200 km	Less Impact
49	Kohlu	Long Term Alignment	50-200 km	Less Impact

Source: Planning Commission



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