



PRIME CPEC Monitor

October 2016

China-Pakistan Economic Corridor's (CPEC) status as Pakistan's flagship economic project continues to grow. Intellectual debate on CPEC has developed considerably since its inception in April, 2015. This debate has accorded two different angles to CPEC. The first of the two has built CPEC's economic rationale by concentrating on its economic benefits to not only China and Pakistan but also to regional economies through high connectivity. The other has focused on its political overtones.

The political debate has focused on CPEC's geostrategic narrative. In Pakistan, political squabbling over route alignment and which one of the three (Eastern, Western, and Central) routes would be completed first has garnered mainstream attention. Quite recently, dialogue on how both Chinese and Pakistani businesses can benefit through CPEC is also initiated especially after CPEC Expo organized in August 2016.

As these discussions continue to expand our understanding of CPEC, it has already entered into its implementation stage. At the same time, it also continues to evolve as priorities are adjusted and new additions to CPEC are incorporated. This is evident from the recent addition of Karachi-Lahore rail line to CPEC project portfolio which not only increases CPEC's price tag to \$51 billion, but also serves as a testament to its evolving nature.

In this first issue of CPEC Monitor by PRIME Institute, we would present an update on CPEC. Rather than contributing to its intellectual debate, we only focus on the progress status of CPEC projects, their functional modalities and financial structure. We also highlight new institutional development around CPEC that government of Pakistan has set in place. Finally, update on CPEC money coming into Pakistan is presented.

1. Update on CPEC Projects

New Project

CPEC project portfolio is upgraded with an addition of Karachi-Lahore rail line project. Under this project, China has committed to upgrade and modernize the Karachi-Lahore railway line called M-1. While estimates differ, as per one source¹ new loan of worth \$8 billion are promised by Beijing for this project. These

loans are on concessional basis as the interest rate is less than 2 percent.²

Shelved Projects

According to the available information, three projects are shelved. These include Gaddani Power Project, Rahimyar Khan coal power project, and Gwadar coal power project. Major reasons behind cancellation of these projects include technical and financial difficulties.

¹ CPEC worth \$51 bn after China ADB approve new loans, Business Standard. Accessed on 20th Oct, 2016.

² Ibid.

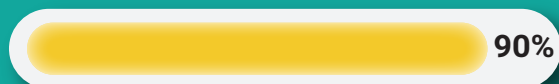
³ Five coal based power projects shelved. The Daily Times 6th Feb, 2015.



CPEC PROGRESS METER

Completion Rates

50MW Dawood Wind Farm



Sahiwal coal, Port Qasim coal, Engro Thar coal-II, Quaid-e-Azam solar, Jhimpir wind, Sachel wind and Karot hydro.



Suki Kinari hydro power project



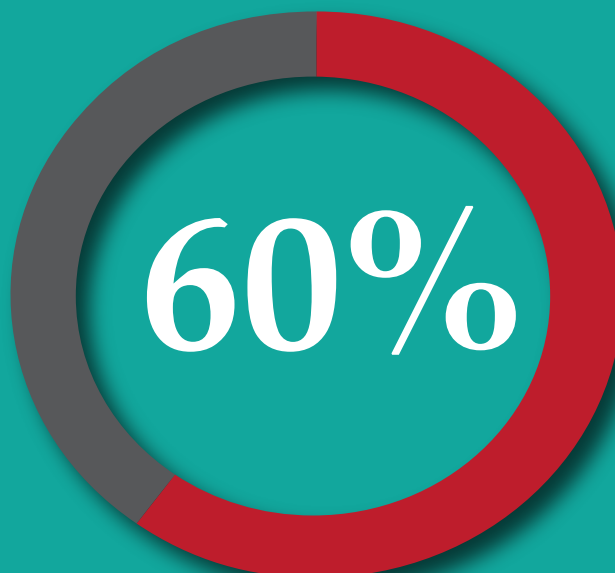
China-Sunnec wind, Rahimyar Khan coal, Thar coal-I, and HUBCO coal



Feasibility of ML-1 upgradation & Havelian dryport



Havelian-Thakot section 120km, Karachi-Lahore motorway 398km



Upgradation of ML-1 (Multan-Lhr, Hyderabad-Multan, Kemari-Hyderabad), New Havelian dryport, Khuzdar-Basima highway, KKH Phase-III, D.I.Khan - Quetta highway



Source: Based on information available at www.cpecinfo.com

Implementation Status of CPEC Energy Projects

CPEC projects are staggered. Implementation status for the early harvest projects under CPEC seems promising. Energy projects like Port Qasim coal fired power plant in Sindh, Sahiwal coal fired power plant in Punjab, Engro Thar coal fired power plant, HUBCO coal fired power plant, Quaid-e-Azam solar park, and Dawood wind farm are well on track to be completed by 2018. Based on this, we can expect that approximately 5670MW of energy will be added to the national grid by 2018. It must be noted here that coal, in most of the cases, is being imported from South Africa and Indonesia since local Thar local is sub-standard due to high intensity of sulfur and lime.⁴

Most of these projects are being built under build-own-transfer principle. Under this principle, any Chinese company building a power plant will own it once it's completed and after securing an agreed-upon profit margin will transfer the power plant to the Government of Pakistan.

As for the financial aspect of these projects, they are all in independent power producers (IPP) mode. The debt-to-equity ratio for projects mentioned above ranges between 75:25 to 80:20. The debt component of this financial arrangement is funded by Chinese banks such as the Export-Import (Exim) Bank of China in the case of the Port Qasim power project and the Industrial and Commercial Bank of China for the Sahiwal power project. Pakistani banks too are loaning out money. HBL, UBL and Bank Alfalah have lent money for the Engro Thar power project.

On the other hand, equity component is divided almost equally between Chinese and Pakistani companies. In case of HUBCO power plant by Hub Power Company (HUBCO) and China Power International Holding Company (CPIH). HUBCO has 49 percent shares while China

International has 51 percent.⁵

2. CPEC: Incentive Measures

Federal and provincial governments are facilitating Chinese investors through various incentives as explained below:

Power Producers

In order to encourage Chinese investors for investing in Pakistan's power sector, National Electricity Power Regulatory Authority (NEPRA), has already approved and notified tariffs for early harvest power projects. These tariff rates are set after taking into account profit margins for power producers. In addition to this, a revolving fund backed by sovereign guarantees has been set up. According to the official statement, a revolving account (equal to 22 per cent of monthly invoicing) shall be opened and maintained by the power purchasers for which the Ministry of Finance will provide the guarantee to fund such revolving account in case the power purchaser fails to place and/ or maintain the required fund.

While this arrangement was initially limited to coal fired power projects, it has now been extended to all power projects. In some instances, Chinese investors are also granted lands at absolutely no cost.⁶

Investment Incentives

The Government of Pakistan has set up various incentives for Chinese investors who wish to invest in Pakistan. While the true nature of these incentives is not clear in most of the cases, there is one instance that can serve as an exemplar. Economic Coordination Committee (ECC) has given multiple set of incentives to China Overseas Ports Holding Company Limited (COPHCL). The development of Gwadar Port was delegated to COPHCL after GoP annulled Singapore Holding Company's contract in 2013.

⁴ Zhong, August 2014, p. 156-157.

⁵ Kiani, K. Rs. 8.12 per unit tariff approved for HUBCO's power project. Dawn 17th February, 2016.

⁶ Land of investment: Pakistan turning into Chinese economy. Shafaqna.com

As per the incentive package, following policy directives are issued:

1. A complete tax holiday for 23 years to businesses that will be established in Gwadar Free Zone. Under this, the concession is extended to contractors, sub-contractors and COPHCL for 20 years.

2. The ECC has exempted the COPHCL and its operating company from paying the minimum 1 percent income tax. Additionally, the ECC has also exempted COPHCL and its operating companies from sales tax and federal excise duty.

3. ECC has approved complete exemption from the 12.5 percent tax on dividend income and withholding tax for the COPHCL, its operating companies, Gwadar International Terminals Limited, Gwadar Marines Services Limited and Gwadar Free Company Limited.

4. Pakistan has granted tax exemption on profit on debt generated by Chinese financial institutions that will lend money for construction and development projects.

5. A 23 year exemption from sales tax and federal excise duty to businesses that will be established inside the Gwadar Free Zones.

6. Exemption from customs duty for COPHCL, its operating companies, contractors, and sub contractors, for 40 years on imports of equipments, plants, machinery, appliances, and accessories for construction of Gwadar port and Gwadar Free Zone.

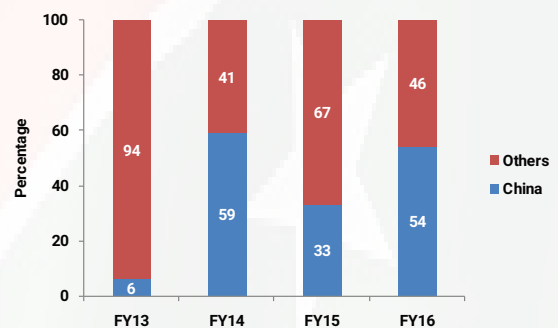
7. This exemption is also extended on import of ship bunkers oils for supplying fuels and lubricants to ships used in the port and its terminals.

8. 23-year duties exempted for port related businesses to be established in the Free Zone. The COPHCL can also import duty free vehicles.

3. CPEC and FDI

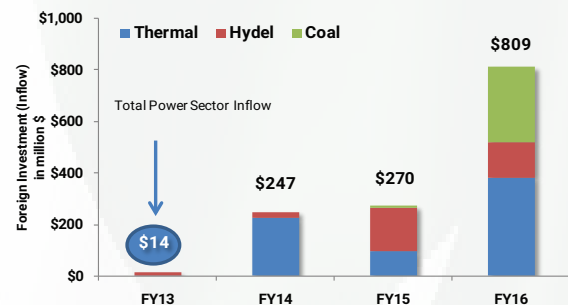
Pakistan's Foreign Direct Investment (FDI) has already started getting visible signs of CPEC money. China's share in net FDI has increased considerably as shown in Figure 1. Most of the money is coming in power sector which is headlined by thermal-related investments. Interestingly, Figure 2 shows that all three sub-sectors of thermal, hydel, and coal have been receiving foreign investments at an increasing rate.

Figure 1: Share of Chinese FDI



Source: State Bank of Pakistan

Figure 2: Power Sector Foreign Investment

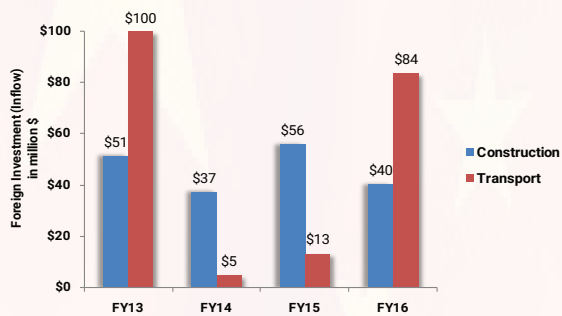


Source: State Bank of Pakistan

Power is not the only sector that has witnessed increase. As CPEC involves development of Pakistani infrastructure as well, foreign investment inflows to construction sector has also somewhat increased specially in FY15. However, as shown in Figure 3 this increase has not been consistent.

Transport sector, on the other hand, has seen sharper uptake in foreign investment inflow. Based on these trends, we can expect that these sectors will remain lucrative options for foreign investors both Chinese and non-Chinese investors. However, if policy incentives are limited only to Chinese investors, the share of the latter may decrease in FDI.

Figure 3: Foreign Investment in Transport & Construction Sector



Source: State Bank of Pakistan

Finally, progress on CPEC is promising. It is strongly recommended that issues should be sorted out in order to build on the positive developments in CPEC's implementation stage.