

# ANALYZING THE STRATEGIC AND ECONOMIC PROSPECTS OF CHINA-PAKISTAN ECONOMIC CORRIDOR

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## Abstract

*CPEC is a mega investment project, termed as a key to rapid economic growth of Pakistan. It is an economic corridor providing connectivity to China, building around which Pakistan is believed to harness economic dividends as time passes. The project has great strategic significance and it contains enormous economic prospects, thus is vital for both the countries. Though, CPEC is not completed yet, it has already started contributing to Pakistan's economy as investment in energy projects has increased electricity supplies. CPEC has attracting private sector investment in to Pakistan, which as per official estimates, is expected to boost economic growth rate to 5.5 percent in the near future. While CPEC is a game changer for the development, government needs to pay attention to develop human capital (health, education, trainings and skills) and infrastructure (western route) in order to develop lagging regions and to improve the living standard of people living there.*

**Keywords:** CPEC, debt sustainability, strategic importance, connectivity, economic gains

## 1. Introduction

The China Pakistan Economic Corridor (CPEC) is the most important project in the history of Pakistan. The CPEC corridor connects Gwadar Port (in Balochistan) to the land-locked region of Xinjiang in north-west of China. The corridor contains 3,000 km long highways, railway lines and pipelines to provide shorter route for oil and gas transportation into China. The importance of CPEC is undeniable owing to the fact that it will benefit both China and Pakistan through improving connectivity. Chinese Premier

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proposed CPEC in May 2013, but the ideas for a corridor (connecting China to Pakistan's deep seaports) goes back as far as to 1959 when the two countries agreed to build the Karakoram highway. In 2002, the CPEC project started to emerge when China initiated<sup>1</sup> construction works at Gwadar port during the military regime in Pakistan. After a detailed homework, it was 2015 (April) when the two countries formally signed the agreement worth \$46 billion (which later extended to \$62 billion). The agreement consisted of the short, medium and long run initiatives, with a handsome fast-tracked "Early Harvest" projects<sup>2</sup> (worth \$35 billion, approximately), which were bound to complete by the end of 2018.

After initial agreement, the project kept on expanding. In December 2015, China agreed to invest additional \$1.5 billion to establish an information and technology park. In addition to huge investment from the Chinese government, CPEC also facilitated economic connectivity between the two countries. The Exim Bank of China agreed to provide concessional<sup>3</sup> loan (nearly \$11 billion at interest rate of 1.6%) to Pakistan to revamp Pakistan's transportation infrastructure.

According to the ADB, CPEC will provide linkages between economic hubs on urban landscapes, a place of businesses and economic resources. These economic hubs can be linked with the supply and demand markets. CPEC will thus perform a critical role in regional integration of China, Iran, and Afghanistan. The economic corridor's central importance is reflected by the fact that China incorporated this project in its 13<sup>th</sup> Five Year Development Plan; a very important document for China defining its growth path. CPEC has been the biggest overseas investment so far by China with an ideal operational time of three years (road connectivity). The volume, speed and scope of the project explains its potential as a strategic game changer in the region. It is anticipated that this volume of investment and connectivity will stage Pakistan as economic hub in the region. In this context, this paper examines the economic and strategic prospects of CPEC.

The paper is structured as follows: The next section provides a critical review strategic significance of CPEC to both the countries. Section 3 discusses provincial and federal governments' differences over the route. Section 4 examines CPEC's impact on Pakistan's economic growth. Section 4 also touches upon the human development and social sector. Section 5

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<sup>1</sup> "Backgrounder: China-Pakistan Economic Corridor". *China Daily*. 22 April 2015. [https://www.chinadaily.com.cn/world/2015xivisitpse/2015-04/22/content\\_20503693.htm](https://www.chinadaily.com.cn/world/2015xivisitpse/2015-04/22/content_20503693.htm)

<sup>2</sup> "Ministry of Planning, Development & Reforms". *www.pc.gov.pk (Press release)*; "Pakistan lands \$46 billion investment from China". *CNN Money*. 20 Apr 2015

<sup>3</sup> "Pak-China 'Technology Park' on anvil". *The Express Tribune*. 2<sup>nd</sup> December, 2015. <http://tribune.com.pk/story/1002185/pak-china-technology-park-on-anvil/>

examines economic return to China. The final section draws main conclusions and gives policy recommendations.

## 2. CPEC Project Financing

US showed resentment to CPEC and has continuously questioned its financial and debt sustainability, therefore, this phenomenon is important to investigate. Pakistan and China signed CPEC agreement in 2015 to start work on projects worth USD 46 billion. Later on, CPEC project financing increased to USD 57.2 billion, with USD 35.3 billion committed as foreign direct investment (FDI) in the energy sector by private Chinese investment companies. Moreover, USD 12.8 billion was committed to investments in public infrastructure projects financed through commercial or government-to-government loans from Chinese entities (see Table 1). Loans taken by Chinese companies are mainly from the China Development Bank and China Exim Bank, against their own balance sheets. The debt would be serviced from their own earnings without any obligation on the part of the Government of Pakistan.

Table 1: CPEC Project Financing (USD Billion)

Avenue of Investment	USD billion
Foreign Director Investment in Energy sector	35.3
Public investments financed through commercial or government-to-government loans from Chinese entities for infrastructure projects	12.8
Public investments financed by Chinese grants	0.4
Public investments financed by non-Chinese foreign loans	0.5
Public investments financed through the GoP's own resources (revenue or domestic debt)	8.2

Source: Planning Commission, Islamabad

Notably, out of the USD 57.2 billion CPEC portfolio, USD 35.3 billion is committed as FDI by Chinese investment companies, which would not create a liability on the Government of Pakistan. USD 8.2 billion is GoP public investments financed through its own resources either through revenue or domestic debt. The USD 12.8 billion government-to-government loans from Chinese entities for infrastructure projects are considered to be concessional, with 2 percent interest to be repaid over a period of 20 to 25 years. In this scenario, additional burden on external accounts is not likely

to result in an unsustainable debt situation. However, revenue from Gwadar port and toll collection is expected to counter balance the additional debt liability generated by CPEC on future balance of payments.

### **3. Strategic Significance**

CPEC has strategic importance in the region since it will develop several trade routes from China to the Central Asia, Middle East and Africa. Over the past decades, China has emerged as a major oil importer due to rising domestic consumption and to fulfill world's growing demand for its products. Therefore, in order to ensure continued production, energy security is critical for the Chinese government. In addition, Western China lies far inwards than its sea ports therefore CPEC will open trade routes, providing it a direct access to the world. This route not only provides China a secure corridor for its oil imports but also provides a shorter route to the oil-rich Middle East and populous Africa (a huge market for consumables). Through Gwadar Port, China can now bypass the lengthier logistical route that it currently opts for via the Strait of Malacca near Singapore in Southeast Asia, which is prone to risks from western and regional powers.

In order to ensure energy security, China has plans to build a refinery and oil storage facilities at Gwadar Port, which would bring even more investment to Pakistan. Moreover, the road network and pipelines will be built to transport oil to its regions in China. This huge investment will allow uninterrupted supply of energy to China, mitigating the risks attached to the current route, which the U.S. (or its allies) or India can block in case of rising of hostilities in the region. Hence, CPEC has vital strategic significance for China while serving even more to Pakistani economy provided that we harness the opportunities well. CPEC will also pave the path of development in western regions of China, where tensions remain due to radical separatists. In the recent developments, Iran has also shown their desire to participate in CPEC and to extend the Iran-Pakistan gas pipeline to China. Hence, due to the CPEC significant importance for development of China, the Chinese government has not only offered to invest in the resource starved road infrastructure of Pakistan but has also made Pakistan a key partner in development.

### **4. Provincial and federal governments' differences on route**

In order to benefit from the emerging opportunities and prove ourselves up to the task, Pakistan needs to deal with the project passionately but at the same time with caution. For this to achieve, are the stakeholders in the country are required to put in coordinated efforts with dedication. However, there happened to be serious initial differences between the federal and provincial governments on routes of CPEC. Initially the provincial governments of Khyber Pakhtunkhwa and Balochistan had expressed serious concerns over the western route of China-Pakistan Economic Corridor

(CPEC) criticizing the federal government that it will only benefit Punjab at the cost of other provinces. The route controversy increased because of initial silence and subsequent contradictory statements by the federal government.

This issue was later resolved amicably by making agreement on three different routes, connecting different parts in all regions of Pakistan. Resultantly, the CPEC route will now connect all the autonomous regions (AJK and Gilgit-Baltistan) and provinces of Pakistan (See **Figure 1**). Importantly, this arrangement is now seen to serve a greater purpose by posing as a driver for regional connectivity between South and East Asia. The following three routes are the proposed routes for CPEC:

- **The Central Route:** This route will go from *Gwadar to-Turbat-Panjgur-Khuzdar-Ratodero-Kashmore-Rajanpur-Dera Ghazi Khan-Dera Ismail Khan-Bannu-Kohat-Peshawar-Hasanabdal-and onwards.*
- **Eastern Route:** This route will also pass through from cities in Punjab starting from *Gwadar to Turbat-Panjgur-Khuzdar-Ratodero-Kashmore-Rajanpur-Dera Ghazi Khan-Multan-Faisalabad-PindiBhatian-Rawalpindi-Hasanabdal and onwards.*
- **Western Route:** Finally Western route pass through most of Balochistan and KP via *Gwadar-Turbat-Panjgur-Khuzdar-Kalat-Quetta-Zhob-Dera Ismail Khan-Bannu-Kohat-Peshawar-Hasanabdal-and onwards.*

While government has been paying attention to resolve these differences, some structural factors are noteworthy. These factors are important for taking a final decision about the route. Firstly, in the case of the western route, the most serious challenge is militancy but is less susceptible to natural calamities. Secondly, while the eastern route faces natural calamities (such as massive floods in the monsoon), the western route (that passes through Khyber Pakhtunkhwa and Baluchistan) lacks in supply of labor and urban economic hubs to provide the needed support to a trade corridor. Hence, these factors needs attention while making further plans for each route.

Figure 1: Three Proposed Routes of CPEC



## 5. Impact on Economic Growth

In 2015, the country was facing energy shortages of over 5,000 MW with power load shedding up to 8-12 hours per day. The economic losses from power load shedding were estimated to be at 2.5% of Pakistan's GDP. Power generation was therefore a major focus while CPEC projects were taking shape, with over \$30 billion invested in energy projects. About 10,400 MW of electricity was aimed at generating by 2018, which were to ease the energy crisis of Pakistan. Individual projects were though financed with private loan from the Chinese Exim Bank at lower interest rates (5-6%). The projects were installed under the power policy where our Government is legally bound to purchase electricity from power producers at pre-negotiated rates.

CPEC is considered to be economically vital for Pakistan because it has great economic prospects for driving higher economic growth in the country. Moody's, an international rating agency, termed the CPEC project as "*credit positive*" for Pakistan. However, a number of the project's key paybacks have to be materialized after 2018. It is expected that CPEC projects will be bringing billions of USD in investment, thus will have positive impact on the balance of payment of Pakistan, reducing country's dependence on foreign donors. This investment will obviously have significant positive effect for Pakistan's economic growth. There are two types of effects of Chinese investment a) direct and b) indirect.

Table 1: GDP Growth Rate and Social Sector Spending, 2013-2018

	2013-14	2014-15	2015-16	2016-17	2017-18
	(%)				
GDP Growth	4.1	4.1	4.6	5.2	5.5
	<b>Rs in million</b>				
Education	537,598	599,047	663,356	699,222	829,152
Health	201,986	231,172	267,953	328,962	416,467
	<b>As % of GDP</b>				
Education	2.14	2.18	2.28	2.19	2.40
Health	0.80	0.84	0.92	1.03	1.20

Source: Pakistan Economic Survey, 2018-19

Through direct effects, Chinese investments has increased GDP growth rate from 4.1% to 5.5% between 2013 and 2018 (see **Table 1**)<sup>4</sup> which was slowed down to around 3% during 2009 to 2014 due to the energy shortages. This is because of the given local component of the investment of about US\$18 billion, with the assumption of higher local investments (50% to 80%) in Rail, Road, Hydel and Gwadar Port and a lower component of investment (20%) for coal based power plants. This has increased 1.4 percentage points GDP growth rate during FY16-18 raising GDP growth rate.

Indirect effects are much greater. While bulk of the investment was utilized for setting up more than 15,000 MW coal based power plants, equivalent to 74% of existing capacity in 2015, the increased electricity supplies have boosted private sector's activities and investment. Consequently, the ratio of private investment to GDP, that on average was on decline (to 9.6% during the FY2009-14), increased to 10.3% during the FY15-18. Similarly private sector credit to GDP that was fallen to 12.6% increased to 18.8% in 2018 showing that CPEC investment has provided the much needed impetus to economic growth by stimulating private investment in the country. CPEC has already increased the country's growth potential in medium term. CPEC investment supplemented annual investment to GDP. As a result, total investment to GDP ratio increased from 14.6% in 2014 to 16.7% in 2018. Consequently, Pakistan's GDP growth rate increased to 5.5% in 2018 from 4.1% in 2014.

<sup>4</sup> Pakistan Economic Survey. Islamabad: Economic Advisor's Wing, Ministry of Finance, 2018-19

Chinese investment in infrastructure coupled with its positive effects on growth has great prospects for human development and poverty reduction. Evidence shows that a higher growth trajectory of 6% per annum resulted<sup>5</sup> in poverty reduction in Pakistan during the 1980s and 2000s. It is obvious that the impact of global financial crisis (GFC) on Pakistan has mainly transmitted through Gulf Financial Crisis due to Pakistan's over dependence on Gulf region<sup>6</sup>. Thus, Chinese investment now, in the form of CPEC, has potential for poverty reduction through its impact on economic growth.

Investment in human capital is essential to reap the benefit of market integration through economic corridor. In Pakistan, investment in human capital remained at 2.1% of GDP in education and 0.8% of GDP in health; in fiscal year, 2013-14 (see **Table 1**). Chinese investment in infrastructure should have helped the government to increase investment in human capital to 3% of GDP in education and 2% of GDP in health sector in order to be comparable with the peer neighboring countries. This would have been possible by switching public sector spending from low priority areas such as metro bus, orange line and other politically oriented schemes towards human development in order to realize the full benefit of the integration of markets and the globalization process. However, investment in human capital increased to 2.4% of GDP in education and 1.2% of GDP in health in fiscal year 2017-18.

## 6. Economic Returns to China

The existing trade route covers the distance of 13000 km, taking 45 days to reach the Persian Gulf from China. On the contrary, the CPEC trade corridor will reduce the distance to 2,500 km where freight will take only 10 days to reach destination, resulting in huge savings for China. In addition, the private investments (majority by Chinese public enterprises) made through CPEC would yield attractive long-term returns, which at the same time serves a big purpose for Pakistan as well being a resource and investment starved developing country. Such investments will bring much better return to China than the US treasury instruments (yielding 1-2% per annum) where China has been parking bulk of its foreign exchange out a total US\$4 trillion.

Further, the projects would benefit the Chinese firms over the long term as the machinery, equipment and aftersales service/maintenance used in the projects/industry is procured from China. In addition, in the short run majority of the projects setup under CPEC would also employ a significant number of Chinese workers. The Gwardar-Xianjiang route will provide a

<sup>5</sup> Talat Anwar, "Role of Growth and Inequality in Explaining Changes in Poverty in Pakistan", *The Pakistan Development Review*, 49(1), (2010): 1-17

<sup>6</sup> Sajid Amin Javed, Badiea Shaikat & Iftikhar Ahmad, "How the Global and Gulf Financial Crises Affected Pakistan: Ten Year Review", *International Migration* (2020)



secure and economical access to the raw material supplies and exports over the long term. Similarly, China is Pakistan's one of the major trading partner. In 2015, the two-sided trade exceeded \$16 billion. In the recent years, Pakistan's exports to China augmented from US\$ 0.4 billion in 2004-05 to US\$ 1.7 billion in 2015-16. On the contrary, imports from China grew heavily and increased from US\$ 1.8 billion to US\$ 16 billion during this period. The bilateral trade balance remains tilted towards China and being a net exporter the trade balance remained heavily in favor of China. Now, CPEC will open up even more avenues for trade and cooperation and China is expected to gain more being a developed country.

CPEC can result in a doubling of trade with China along with transfer of technology benefiting both countries. Pakistan can reduce its trade deficit by exploring more avenues in China, which is a big market of one billion plus consumers. The Free Trade Agreement (FTA) will serve as catalyst in this regard. There is a need to provide incentive to country's private sector through promoting Business-to-Business contacts and facilitating joint ventures. This will help the domestic firms to modernize, benefit from Chinese research and development, train internal human capital, obtain international certifications, and oblige quality standards in accordance with consumers' demand. In addition, in the backdrop of continued restructuring in Chinese economy, Pakistan's private sector can also benefit from Priority Special Economic Zones under CPEC, which are there to facilitate relocation of labor-intensive industries<sup>7</sup>.

## **7. Conclusions and Policy Recommendations**

CPEC has great strategic and economic importance for Pakistan and China since it will facilitate several regional corridors and trade routes from China to Central Asia, Middle East and Africa. CPEC will open trade routes and deliver China a direct access to populous Africa and the oil-rich Middle East region through the Gwadar Port avoiding the lengthier route it currently uses.

Out of the US\$ 57.2 billion CPEC project financing, US\$ 35.3 billion is committed as FDI by Chinese investment companies, whereas the remaining amount is concessional loan to be paid over 20-25 period, which is not likely to create an unsustainable debt burden on Pakistan. CPEC has great economic and social prospects and is vital for both the countries, as benefits will accrue to both. The project will allow Gwadar to strive with Persian Gulf ports benefiting the province as well as the country. It will allow goods

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<sup>7</sup> Iftikhar Ahmad & Zhou Taidong, "Special Economic Zones in Pakistan: Promises and Perils", *PIDE Research Report* (2020)

and energy to move from and into China through a shorter and secure land route resulting in huge saving for China and generating billions of dollars for the region.

Concurrently, CPEC offers great opportunities for Pakistan's economy. Huge investments in energy projects has increased electricity supplies attracting private sector investment in the country and stimulated economic growth rate to 5.5 percent per annum in 2018. The project can also result in an increasing trade with China, along with transfer of technology benefiting both countries. CPEC also provide great opportunity for exploring possibilities for collaborative research projects between Chinese and Pakistani Universities.

While CPEC has emerged as a game changer for the development, government needs to pay a attention to develop western route in order to develop remote and under develop regions which will have a profound impact on the living standard of people who are left behind. It will also eliminate provincial differences as lack of consensus among the smaller provinces over CPEC schemes may lead to fragmentation of the country. Last, but not the least, Pakistan needs to pay proper attention and allocate adequate resources for human development to cater with future needs in wake of post-CPEC scenario.

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