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CPEC

Review of Implementation Challenges and Near-term Revival Prospects

Expert Roundtable held at the Centre of Research and Security Studies (CRSS), Islamabad, 27th September 2024

SUMMARY

The China-Pakistan Economic Corridor (CPEC), was launched in 2015 as part of China's Belt and Road Initiative (BRI) to improve Pakistan's infrastructure, boost economic growth, and create regional connectivity. However, CPEC has encountered numerous implementation challenges since its initiation, particularly in the planning, construction, and operation of key projects. Financial constraints, management inefficiencies, and political instability have also contributed to slowing progress. Phase 1 of CPEC focused on the implementation of Government-to-Government (G2G) strategic projects, such as electricity generation and road transport systems.

The Phase 2 of CPEC is anchored around attracting Business-to-Business (B2B) joint ventures by mainly attracting private Chinese re-location of investments that will strengthen Pakistan's industrial base. China has in the last few years emerged as the 2nd largest investor in renewable energy. Chinese have also entered investment partnerships with the Pakistani private sector in the agricultural and automobile sectors.

However, structural issues within Pakistan's governance, concerns about repayment to Chinese creditors, repatriation of profits to investors in power projects, and the sustainability of loans remain serious concerns. Extremely slow development of special economic zones (SEZs) and security issues continue to pose major concerns for the long-term success of CPEC.

To address the ongoing challenges and future prospects of CPEC, a focus group discussion was organized at the Centre of Research and Security Studies (CRSS), held on 27th September 2024, brought together experts to provide an in-depth analysis on critical issues such as financing, technology, management, and their broader impact on Pakistan's economic and infrastructural development.

DISCUSSION:

During the session, three main questions were posed to the experts: a) the challenges in constructing and operating CPEC projects, b) the role of government departments in promoting these projects, c) the feasibility of the initial goals set for CPEC, and d) what should be the way forward. Below are the key inputs from the experts.

The Pakistani government claims to have made commendable efforts to assist in the implementation of CPEC projects, with about 90% of its initiatives being recognized as effective, given the scale and complexity of the project. However, several **structural inefficiencies** within the governance system in general have hindered the project's implementation pace.

1. **Bureaucratic (in) Capacity & Lethargy:** Political instability and COVID-19 disruptions led to delays in both **government-to-government (G2G)** and **business-to-business (B2B)** projects, particularly in **Special Economic Zones (SEZs)**. Coordination issues between federal and provincial governments further complicated implementation efforts. Bureaucracy has been a big obstruction in the way of speedy decision-making and implementation.
2. **Slow decision-making at various tiers of governance**: One must keep in mind the anti-China or pro-West lobbies within the government institutions which cause delays in decisions and implementation.
3. **Limited Industrial Sector Growth:** Most investments went into the road communication and power sector with the result that the Chinese investments were not able to generate a single dollar revenue because there was no focus on enhancing industrial production capacity. One missed opportunity was the failure to expand the existing industrial sector, which could have helped to increase electricity demand and, thereby, lower average generation costs.
4. **Low Productivity of the human resource:** Not enough skilled labour familiar with the Chinese work ethics.
5. **Unstable Exchange Rate**: The fluctuating exchange rate is driven by the deteriorating Rupee value creating uncertainty for businesses and investors.
6. **Security Concerns:** The government established **Special Security Divisions (SSD)** to protect CPEC-related activity and it was an attempt to address Chinese security concerns. However, the performance of this Division remains questionable (cow-boy style security). SSD remains under-resourced, leaving Chinese workers vulnerable, particularly in Baluchistan and northern Pakistan.
7. **Political instability**: Pakistan has seen a vicious cycle of instability since early 2022. The government's overall efficacy and performance remain mixed. The ongoing **political instability has affected the implementation pace of CPEC projects.**
8. **Lack of coherence between provincial and federal authorities:** The discord between the two continues to impede the smooth implementation of CPEC projects. Unlike China, where it is the Communist Party that steers the decision-making, and implementation, Pakistan is a four-province federation with a complex decision-making process.
9. **Outstanding repayments to Chinese power companies:** Nearly US$2 billion worth of repayments to Chinese are in arrears. Pakistan is still unable to make those repayments.
10. **IMF Restriction on Loan:** The IMF has also barred Pakistan from using the IMF loan for making payments to Chinese power companies.

11. **Inconsistent electricity supply to Gwadar's Free Industrial Zone**: The 300-MW power plant at Gwadar has yet to take-off because of a dispute over tariff setting. It has been revised five times but the Chinese company has not yet accepted it and precluded further downward revisions.

FLAWS OF CPEC GOALS AND DESIGN

Some of the initial goals of CPEC were overly ambitious, with unrealistic timelines and design flaws that have hindered the promised benefits of CPEC from reaching its full potential.

1. **Unrealistic Project Timelines:** Some projects, like ML-1, were expected to take **10-12 years** for completion, yet these were included in the Phase 1 projects pipeline, which led to an overestimation of what could be achieved within the set timeframe. Similarly, there was too much emphasis on power generation capacity and not enough focus on enhancing the existing dismal industrial productivity.
2. **Reliance on Non-tradable Investments:** Pakistan's heavy reliance on non-tradable investments (i.e., infrastructure that does not directly generate export revenues) has not resulted in sustainable economic growth. The country's **rupee-based revenue generation** of industrial output limits its ability to repay foreign currency loans and benefit fully from CPEC projects.
3. **Geopolitical Shifts:** The original design of CPEC also did not fully consider alternative routes available to China, such as those through Iran. The **IMF's** discouragement of CPEC-like projects further restricts Pakistan's ability to expand the initiative.
4. **Security and Political Hurdles:** The security situation in Baluchistan requires either kinetic action or a political settlement on the western belt which directly impacts projects like Gwadar, that remain underutilized.
5. **Power Sector agreements:** They were not prepared with enough care and due diligence, with the result that repayments to most Chinese power producers are restricted or in arrears.

NEW PROPOSALS AND RECOMMENDATIONS

The **new proposals for CPEC 2** include a shift in focus from G2G to B2B projects. The proposal, shared by the Chinese side, is not legally binding but outlines several potential initiatives, particularly in the **renewable energy sector**.

1. **Solar Energy Expansion:** To address the Chinese grievances about inconsistent power supply, one of the alternative proposals from the Pakistani government is a solar/hybrid energy conversion project for Gwadar, which would reduce dependency on coal and Iran's unreliable power supply.

2. **Infrastructure Development:** There are discussions around a new grid linking **Karachi to Gwadar**, which could address power shortages in the port region. This would be a significant step in making Gwadar more attractive to international investors.

There is a pressing need for Pakistan to shift towards **efficiency-seeking Foreign Direct Investment (FDI)** instead of relying on market-seeking FDI. The country should prioritize **export-oriented industrialization** and develop the productivity of its **human capital**, which is currently one of the lowest in the region. By improving labor productivity, Pakistan can better compete, with countries like Vietnam, which attracted US$15 billion in FDI between January and June 2024 and exported more than US$150 billion over the same period.

BROADER ISSUES AND COMPARATIVE ANALYSIS

There are concerns about an elitist bias in Pakistan, with the upper class aligning with Western interests and showing resistance to Chinese investments. Meanwhile, the middle class tends to support China's role in Pakistan's development. However, outdated models like the **Board of Investment's one-size-fits-all approach, as well as the existence of several parallel structures such as the CPEC Secretariat, and Special Investment Facilitation Council** have systemic complexities due to overlapping, duplicating mechanisms with little achievements.

In contrast, countries like Vietnam and Indonesia have implemented policies that attract Chinese e-location investments while boosting domestic productivity, offering valuable lessons for Pakistan to focus on **efficiency-led growth** rather than market-seeking investments on the back of tariff protection.

CONCLUSION AND RECOMMENDATIONS

To fully benefit from CPEC, Pakistan must primarily address its internal challenges. The following recommendations were made:

1. **Bureaucratic Reforms:** Pakistan's bureaucratic system requires a redesign, particularly in terms of economic governance, to ensure smoother implementation of CPEC projects. Or Chinese investors shall have to adapt themselves to this slow-moving bureaucratic machinery.
2. **Export-Oriented Growth:** Pakistan's economy must shift toward a **productivity-led and export-oriented growth strategy** rather than relying on debt-financed growth and development.
3. **Instead of mega projects, China should focus on cluster-based Development in Pakistan:** A **cluster-based approach** should be adopted to scale up industrial clusters, promote productivity, and attract FDI to participate in the global supply chain of Chinese companies.

4. **Workforce Development:** China should help Pakistan prioritize developing a skilled workforce aligned with the Chinese investment needs. This includes fostering a ***strong work ethic*** and improving labor productivity.

5. **Security:** Addressing security concerns of Chinese investors throughout the country, particularly in Baluchistan and KP by ensuring the properly resourced operations of the **Special Security Division (SSD).**