



P O L I C Y B R I E F

CHINA PAKISTAN ECONOMIC CORRIDOR

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Abbreviation	Details
BRI	Belt and Road Initiative
Bn	Billion
CPEC	China Pakistan Economic Corridor
CPFTA	China Pakistan Free trade Agreement
EHP	Early Harvest Project
FDI	Foreign Direct Investment
FTA	Free Trade Agreement
GDP	Gross Domestic Product
IMF	International Monetary Fund
JWG	Joint Working Group
ML-1	Main Line- 1
MoU	Memorandum of Understanding
Mn	Million
MW	Megawatt
OFDI	Outbound Foreign Direct Investment
PKR	Pakistan Rupee
SEZ	Special Economic Zones
UNDP	United Nation Development Programme
USD	United States Dollar

The China Pakistan Economic Corridor is a significant part of China's Belt and Road initiative with a vision to revive the ancient silk route and improve the Chinese connectivity with more than 60 countries spread across Asia, Europe and Africa. CPEC envisaged in 2013 and launched in April 2015, is a set of projects focussing on infrastructure, transportation networks, energy and special economic zones in Pakistan.

CPEC initially came into force with the signing of 51 Memorandum of Understanding (MoUs) between China and Pakistan. CPEC, which comprises of investments that grew from USD 47 billion to around USD 62 billion, travels a 2,700km route. It aims over a period of 15 years to create an economic corridor between Gwadar Port and China's North Western region of Xinjiang through the long highway from Kashgar to Gwadar, development of railway links for freight trains, oil and gas pipelines and an optical fiber link. This project will boost ties between China and Pakistan, which share a history of congenial strategic relations, over a versatile canvas of mutual interest spanning a time period of more than six decades.

Over the years, China and Pakistan have developed strong bilateral trade and economic collaboration as a result of which China has become Pakistan's largest trading partner. The bilateral trade between the two countries has increased from USD 50 million in the mid-1970s to USD 14.5 billion in 2019. Pakistan's trade and investments with China witnessed an overall increase after the signing of the CPFTA and the CPEC agreement. Pakistan's FDI from China has seen a jump from 17 percent in 2007 to 62 percent of its total FDI in 2013 and of the total FDI of USD 2.4 billion for the fiscal year 2017-18, 61 percent was from China. With regard to trade, China's share in Pakistan's exports stood at 9 percent and for imports China has been Pakistan's top supplier of goods for the last five years. Pakistan's imports from China form a significant percentage of its global imports (25 percent in 2019). Because the trade deficit is increasingly in China's favour, reducing its trade deficit and improving its exports is high on the agenda of Pakistan's business community and the policymakers. Hence, the CPFTA is further put into its second phase in January 2020 offering a significant improvement in Pakistan's tariff access to China with Pakistan getting tariff relaxation and duty-free market access for 313 tariff lines to further boost Pakistan's exports.

CPEC has undeniable economic and strategic importance for China and Pakistan. It has been called a game-changer because of its expected economic benefits, regional integration, vast networks, connectivity and partnerships. After the completion of the project, China and Pakistan are likely to play a more active role in the regional and international sphere. The corridor will link China with markets in Central Asia and South Asia. Presently, China is around 12,000 km from the Arabian Gulf with a shipping time of about 45 days. CPEC will shrink this distance and time by almost 80 percent to merely 2,000 km and 10 days. The bulk of China's trade is through the narrow sea channel of the Strait of Malacca. CPEC, besides providing an alternate route, will reduce the shipping time from China to Europe.

Within Pakistan, the economic and development project prioritises transport infrastructure, industrial development, energy and Balochistan's strategically located Gwadar port. Agricultural modernisation and production, and job creation are other critical components. The largest part of the project would provide electricity to energy-deficit Pakistan, going through hours of daily scheduled power cuts. The plan envisages adding 17,000 megawatt of electricity to the national grid of Pakistan, building of various railway tracks and upgrading of existing ones and introducing a shift in the modes of transport wherein a significant portion of trade will be transported to the land route. With the development of Gwadar port, Pakistan is believed to become the hub of regional economic activity. The development of highways, railway lines, gas pipelines and economic zones under CPEC can potentially make Pakistan economically strong and self-reliant.

From the Indian lens, the most important benefit from the success of CPEC will be the infrastructure development which will help various parts of the region. Further, if India engages with China and Pakistan in CPEC, it will find an alternate route for Chinese imports through the Gwadar port than trading through the Indian Ocean as doing currently. Despite the potential trade and infrastructural benefits, Indian opposition to CPEC appears to be more dominant. India's apprehensions around CPEC mainly revolve around the trust deficit, lack of transparency on China's strategic initiative and countering of India's position in South Asia. The Gwadar port envisioned under CPEC might end up like the Hambantota port of Sri Lanka as the two represent some astounding similarities.

CPEC offers an opportunity to upgrade Pakistan's outdated and dysfunctional infrastructure, and revive the failing economy. The German Industrialisation process sets a lesson for Pakistan on how a massive infrastructure project that promises development, requires a pre-requisite technological know-how, political will and stable political environment within the country. In order to deliver on these promises, both Pakistan and China need to implement it with considerably more political will and consultation. CPEC can be a win-win situation not only for China, India, or Pakistan but for other landlocked South Asian nations as well, providing them an alternate route to trade with the world.

INTRODUCTION: CHINA-PAKISTAN TRADE DYNAMICS

In May 1951, the diplomatic relations between China and Pakistan were established but the economic relations go back to the 13th century when Chinese traders used the ancient Silk route through Pakistan to trade with the Middle-East, Europe, and the rest of the world. The trade volume between China and Pakistan largely remained trivial and did not contribute significantly to the economic partnership between the countries until the early 2000s.

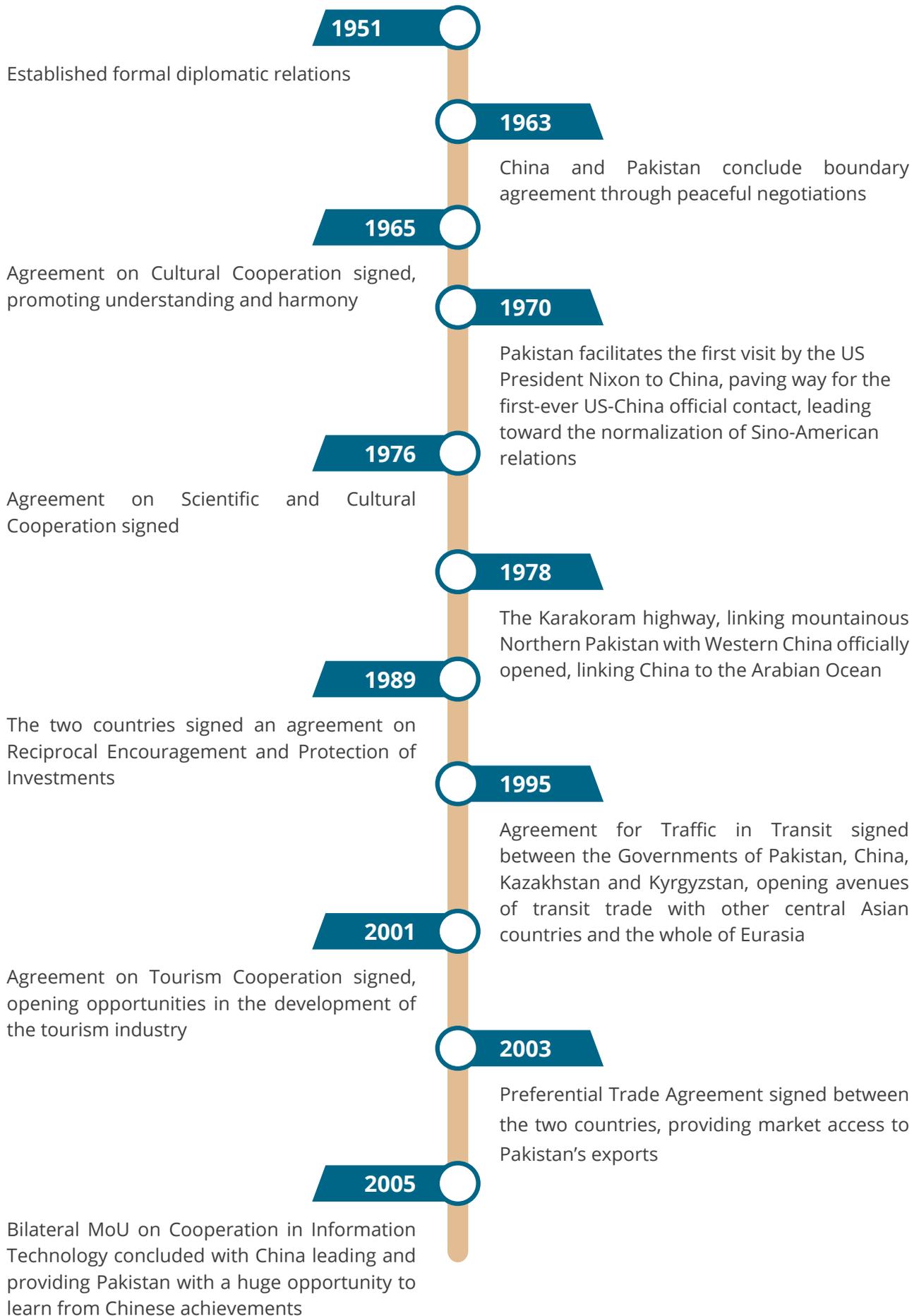
The trade relations between China and Pakistan started with the establishment of the China-Pakistan Joint Committee (1982) aimed at facilitating trade and technology between the two countries. The overall trade between the two countries has substantially improved from being as low as USD 50 million in the mid-1970s to USD 14.5 billion in 2019. The Joint Committee was the beginning of new trade relations which were followed by the signing of multiple MoUs between China and Pakistan. For example, China and Pakistan signed six MoUs on trade in 2001, agreed on establishing cooperation on Gwadar port in May 2002; and signed seven agreements in the areas of trade, communication, and energy sector in 2004.¹ This further enhanced the relations which led to the signing of 21 MoUs in 2005 in the sectors of defence, energy, infrastructure, social sector, etc.² As a result of these developments, the bilateral trade between the two countries increased significantly from USD 1.07 billion in 1997 to USD 4.26 billion in 2005.³

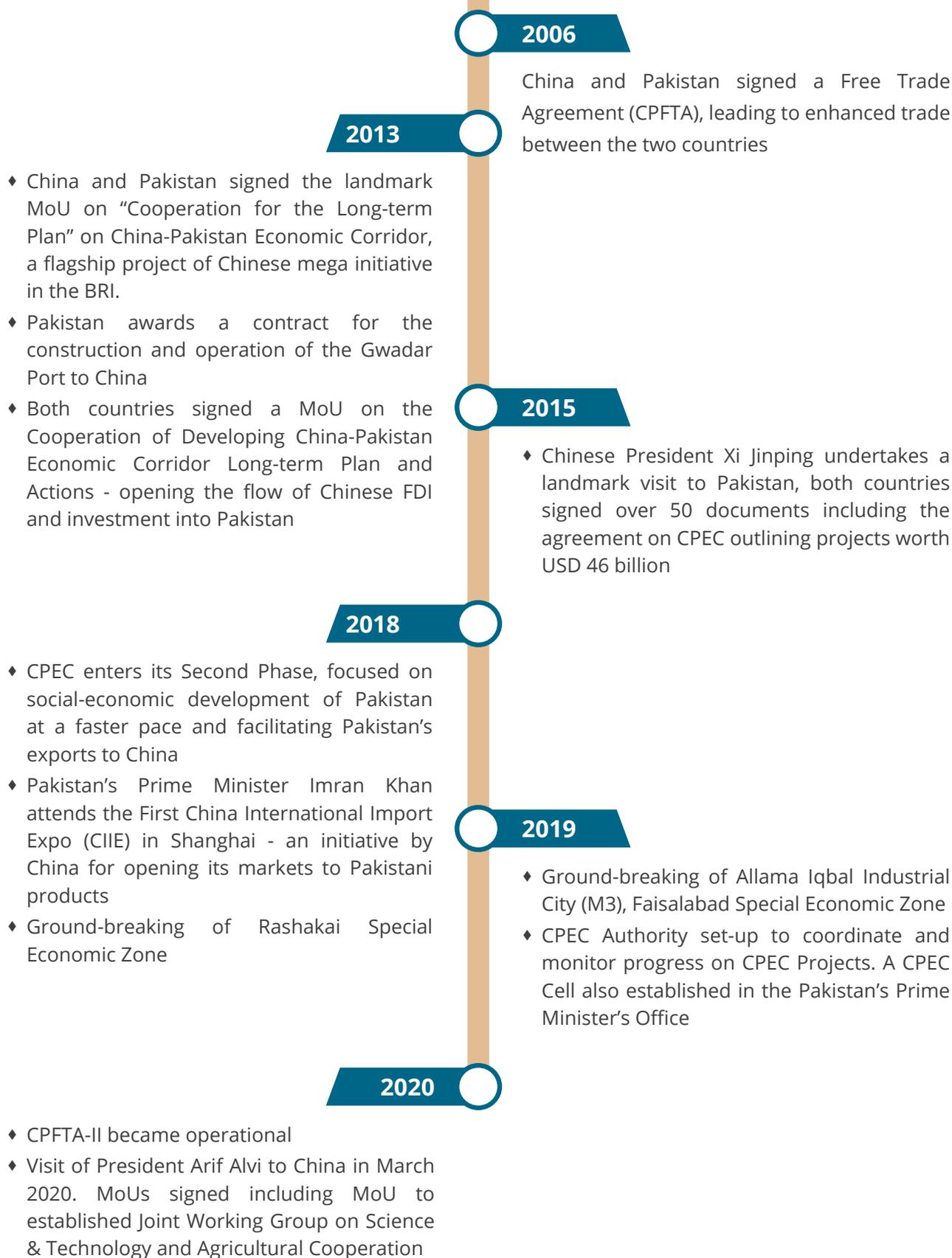
¹ Pakistan China trade Balance. State Bank of Pakistan.2017. <https://www.sbp.org.pk/publications/staff-notes/Pak-China-trade-balance.pdf>

² Azeemi, Haris Raqeeb. 55 Years of Pakistan-China Relationship. Pakistan Institute of International affairs. 2007

³ Pakistan China trade Balance. State Bank of Pakistan.2017. <https://www.sbp.org.pk/publications/staff-notes/Pak-China-trade-balance.pdf>

Trade Timeline between China and Pakistan





Source: China-Pakistan: A journey of friendship (1950-2020). Global Times 2020.⁴

⁴ China-Pakistan: A journey of friendship (1950-2020). Global Times 2020. <https://www.globaltimes.cn/content/1189007.shtml>

A real breakthrough between the trade relations of the two countries occurred with the inception of the China-Pakistan free trade Agreement (CPFTA) of 2006 (came into effect in 2007), and the China Pakistan Economic Corridor (CPEC) which is a significant part of China's "Belt and Road" initiative of 2013 that became operational in 2015. Such mega-projects between China and Pakistan introduced a new dimension in the promotion of bilateral trade. Following these events, the bilateral trade between the two countries flourished immensely, increasing from USD 4.8 billion to USD 14.5 billion, growing by over 200 percent from 2007 to 2019, which is nearly seven times faster than the growth of Pakistan's trade with the rest of the world. The exports from Pakistan to China increased from USD 0.6 billion in 2007 to USD 2.0 billion in 2019, and the imports increased from USD 4.2 billion to USD 12.4 billion.⁵

Table 1: Pakistan's trade following CPFTA1, 2007- 2019 (USD billion)

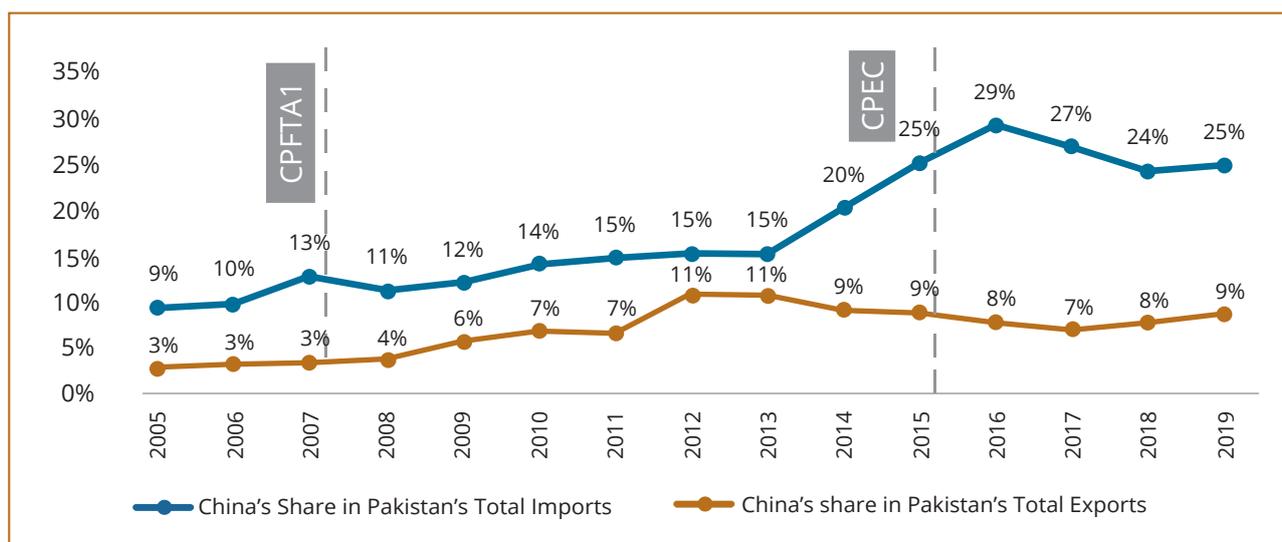
		2007	2019	Growth (percent)
Trade with all countries		50.4	74.0	47
China	Exports	0.6	2.0	233
	Imports	4.2	12.4	198
	Trade balance	(3.6)	(10.4)	192
	Total trade	4.8	14.5	203
Rest of the world (excluding China)	Exports	17.2	21.8	26
	Imports	28.4	37.7	33
	Trade balance	(11.2)	(15.9)	42
	Total trade	45.7	59.5	30

Source: International Trade Centre Database

Tracking the trend of Pakistan's exports to China based on the data from International Trade Centre, China's share in Pakistan's global exports witnessed an increase from 3 percent in 2007 to 11 percent in 2012 and remained at an average of 8 percent of the total Pakistan's exports afterwards. On the other hand, imports from China have enormously increased after the implementation of CPFTA1 – from 13 percent in 2007 which peaked to 29 percent in 2016 and remained at an average of 25 percent 2016 onwards.

⁵ International Trade Centre(ITC) database

Figure 1: China's share in Pakistan's Imports and Exports (2005-2019)



Source: International Trade Centre Database

China has been Pakistan's top supplier of goods for the last five years and Pakistan's imports from China form a significant percentage of Pakistan's global imports (25 percent in 2019). Major imports include electrical equipment, machinery, nuclear reactors, iron and steel, organic chemicals, and man-made filaments – constituting 67 percent of Pakistan's total imports from China. The products which are mainly exported from Pakistan to China are cotton yarn, rice, alcohol and other spirits, copper and related products, and chromium ores which comprise more than 62 percent of Pakistan's total exports to the country.

Table 2: Pakistan's Top Imports from China, 2019

Product Code	Product Description	Value of Imports from China (USD bn)	Percent (%) share of Imports from China of Pakistan's Total Imports
85	Electrical machinery and equipment and parts thereof; sound recorders and reproducers, television ...	3.2	26
84	Machinery, mechanical appliances, nuclear reactors, boilers; parts thereof	2.3	19
72, 73	Iron and steel, Articles of iron or steel	1.3	11
29	Organic chemicals	0.9	7
54	Man-made filaments; strip and the like of man-made textile materials	0.5	4
	Total Imports from China	12.4	

Source: International Trade Centre Database

Table 3: Pakistan's Top Exports to China, 2019

Product Code	Product Description	Value of Exports to China (USD bn)	Percent (%) share of Exports to China of Pakistan's Total Exports
52	Cotton	0.8	40
74	Copper and articles thereof	0.3	15
10	Cereals	0.3	14
3	Fish and crustaceans, molluscs and other aquatic invertebrates	0.1	7
26	Ores, slag and ash	0.1	4
17	Sugars and sugar confectionery	0.1	4
	Total Exports to China	2.0	

Source: International Trade Centre Database

With the rising bilateral trade between the two countries, there is an increasing concern of trade deficit in Pakistan. It is widely believed that the terms of the first phase of CPFTA (2007-2012) were disproportionately in China's favour resulting in a greater increase in imports in comparison to exports from Pakistan. As a result, Pakistan's trade deficit with China increased from USD 3.6 billion in 2007 to USD 12.8 billion in 2018.⁶ There are various reasons for the increasing trade deficit between the two countries such as; the structural economic differences (China being a manufacturing hub in Asia), Pakistan's capacity issues relating to infrastructure, the continuing power shortage, and also lack of skilled labour. Reducing its trade deficit and improving its exports is high on the agenda of Pakistan's business community and the policymakers. Hence, the CPFTA has been further put into its second phase in January 2020, in order to improve the trade imbalance between the two countries. The China Pakistan Free Trade Agreement phase 2 (CPFTA2, 2019-2024) offers significant improvement in Pakistan's tariff access to China with Pakistan getting tariff relaxation and duty-free market access for 313 tariff lines to further boost Pakistan's exports (a jump to 75 percent as compared to 35 percent in phase one, in terms of tariff lines elimination).⁷

With the second phase of the CPFTA, there is a possibility of relocating production of international brands, many of which have facilities in China that import cotton fabric from Pakistan as raw material—to Pakistan itself. The inflow of Chinese investment in machinery and technology in order to setup production bases in Pakistan will drive innovation and economies of scale, thereby making Pakistan regionally competitive in cotton-based garments. In addition, Pakistan will garner a favourable position for exporting to other markets that have so far been trading primarily with China. Under the CPFTA2, many Pakistani textile products

⁶ International Trade Centre Database

⁷ Afraz, Nazish, Salman, Zara. China Pakistan Free trade Agreement Phase 2: A preliminary Analysis. Consortium for Development policy research. 2019. <https://cdpr.org.pk/wp-content/uploads/2020/03/China-Pakistan-Free-Trade-Agreement-Phase-2-merged-final.pdf>

will now enjoy duty-free access to China, which has extended similar tariff reductions to other trading partners - Bangladesh, Thailand and Vietnam among others - under the ASEAN-China FTA. Tariffs on readymade cotton garments (HS codes 61, 62 and 63), have been massively reduced. For example, men’s ensembles of cotton (HS code – 62032200), Pakistan’s top world export, was traded with China at 17.5% (MFN rate) which reduced to 12% under phase I of FTA and has dropped to 0% in the phase II of FTA. This places Pakistan at a more than equal footing with Bangladesh, and ahead of India which faces a tariff rate of 8% on export of this product to China.⁸

Figure 2: Pakistan-China Trade Flows and Deficit, 2005-2019 (USD billion)



Source: International Trade Centre Database

The global focus, however, is on China-Pakistan Economic Corridor (CPEC) which is being considered as a game-changer, not only for China and Pakistan but also for the entire region.⁹

Economic Corridor serves as a link between infrastructure, production and trade within a defined geographic framework, at the centre of which are the economic activities. They are designed with the aim of linking and developing the remote inaccessible areas or landlocked regions through the development of transport infrastructure in the region. Economic Corridors promote regional integration, economic development and employment opportunities within the region and even beyond the region. They are also important in assimilating and creating global, regional and domestic value and supply chains through connecting the economic nodes of the region. For this reason – economic corridors are also considered as ‘drivers of inclusive growth.’¹⁰

⁸ Singla, Nikita. Arora, Priya. China Pakistan FTA-2: A New Regional Hub for Cotton Garments in the Offing. Outlook. 2020. <https://www.outlookindia.com/website/story/news-analysis-china-pakistan-fta-2-a-new-regional-hub-for-cotton-garments-in-the-offing/348942>

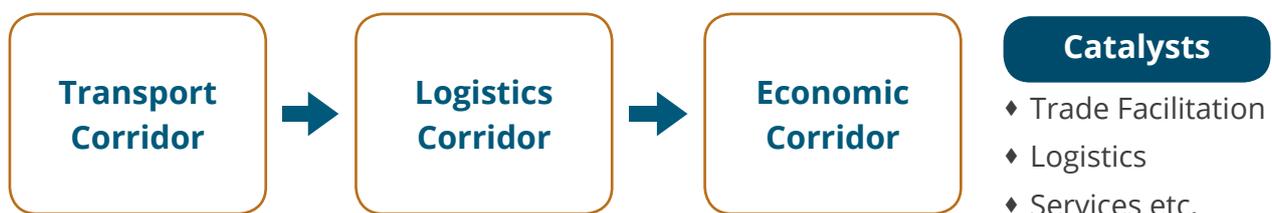
⁹ Pakistan China trade Balance. State Bank of Pakistan.2017. <https://www.sbp.org.pk/publications/staff-notes/Pak-China-trade-balance.pdf>

¹⁰ Brunner, Hans. What is Economic Corridor Development and What Can It Achieve in Asia’s Subregions? .ADB Working Paper Series on Regional Economic Integration.2013

For example, the Great Lakes and the St. Lawrence trade corridor is a significant corridor in North America, connecting the USA and Canada. It recorded a transit of around 230 million metric tonnes of cargo amounting to USD 77.4 billion worth of goods annually. According to a report on the corridor, the marine cargo and vessel activity generated an economic impact of USD 45.6 billion for the US and Canada, which includes USD 17.9 billion of personal income and USD 9 billion of tax revenue. Further, it is estimated that 328,500 direct and indirect jobs have been sustained by the port activities on the corridor.^{11,12}

There are four stages of development of an economic corridor. Since a corridor begins with the connectivity of a road or a highway, connecting at least two nodes - the first stage is to view it as a means of transport. As the usage of the corridor increases and more people and freight start moving along the corridor, the logistics and institutional infrastructure also needs improvement to maintain and increase the efficiency of the corridor and the corridor evolves as a logistic corridor in the second stage. Further, as the economic activities along the corridor increase, it becomes more efficient in terms of travel time leading to increase in investments. A corridor then finally evolves as an economic corridor. The main catalysts in the development of an economic corridor are trade facilitation and logistics services.^{13,14} An efficient economic corridor facilitates trade and investment, helps in generating more output and promotes regional cooperation by reducing tariff based barriers.

Figure 3: Stages of Development of an Economic Corridor



Better infrastructure encourages industrial and manufacturing activities, and improves socio-cultural benefits such as people to people connect between the nations.¹⁵ Therefore, it can be concluded that the benefits an economic corridor achieves or strives to achieve depends firstly on the individual characteristics of the economic nodes and secondly on which characteristics corridor development are intended to introduce or strengthen.

¹¹ The economic impact of North America's most vital trade corridor. Visual Capitalist. 2018 <https://www.visualcapitalist.com/economic-impact-north-america-trade-corridor/>

¹² A brief history of North America's most vital trade corridor. Business Insider. 2018 <https://www.businessinsider.com/a-brief-history-of-north-america-s-most-vital-trade-corridor-2018-7?IR=T#:~:text=The%20Great%20Lakes%20and%20the,Canada%20for%20a%20long%20time.>

¹³ De, Prabir. Iyengar, Kavita. Developing economic corridors in South Asia. Asian Development Bank. 2014. http://ris.org.in/sites/default/files/Developing%20Economic%20Corridors%20%28webversion%29%20%2028.4.15_0.pdf#page=32

¹⁴ Hope, Albie. Cox, John. Development Corridors. EPS-PEAKS. 2015. https://assets.publishing.service.gov.uk/media/57a08995e5274a31e000016a/Topic_Guide_Development_Corridors.pdf

¹⁵ Siegfried Wolf. The China-Pakistan Economic Corridor of the Belt and Road Initiative: Concept, Context and Assessment. Contemporary South Asian Studies. 2020

THE CHINA PAKISTAN ECONOMIC CORRIDOR

CPEC is the lead project of China's "Belt and Road initiative" (BRI) also called "One Belt, One Road" (OBOR) initiative. The main vision of BRI is to connect the geographical regions of Eurasia, South East Asia, South Asia and Africa through roads, railway lines, maritime routes and energy infrastructure. The BRI project is estimated to have an investment of USD 4-8 trillion and the participating countries will account for 64 percent of the global population, and around 29 percent of the world GDP.¹⁶ The BRI project is divided into two parts (i) Silk Road Economic Belt – a land based route to connect China with Central Asia, Eastern Europe, and Western Europe (ii) 21st Century Maritime Silk Road - a sea-based structure designed to connect China's southern coast to the Mediterranean, Africa, South-East Asia, and Central Asia.^{17,18} It is believed that a new era of regional and economic diplomacy has begun with the initiative of China's BRI project covering Asia, Africa and Europe.¹⁹

CPEC is an economic undertaking which was first proposed by China's Premier Li Keqiang during his visit to Pakistan in May 2013, the project was approved in July 2013.²⁰ The critical geostrategic position of Pakistan is important for China as it will serve as a southern gateway towards South Asia, and western gateway towards the Middle East.²¹ It is planned to link the city of Kashgar in Xinjiang of Western China and the Gwadar Port in Baluchistan, Pakistan. In 2015, during the Chinese president Xi Jinping's visit to Pakistan, both the countries formally announced the USD 46 billion economic corridor project (increased to USD 62 billion) and signed 51 MoUs, with around USD 28 billion dollars of fast tracked 'Early Harvest' projects to be developed by the end of 2018. The project formally came into force in 2016 with the arrival of first convoy from China to Gwadar.^{22,23}

The major flow of investment under CPEC will be directed towards Energy Projects (74 percent) and other sectors including High Speed Railways (8 percent), Motorways & Highways (9 percent), and Gwadar Port, Economic Zones and laying fiber optics (9 percent).²⁴ CPEC being the major investment in energy, aims to add 17,000 megawatt of electricity to the national grid

¹⁶ Rahman, Saif. Shurong, Zhao. Analysis of Chinese national and security interests in China Pakistan Economic Corridor (CPEC) under the framework of One Belt One Road (OBOR) initiative. School of Political Science and Public Administration. 2017

¹⁷ One Belt One Road (OBOR). Investopedia. 2020. <https://www.investopedia.com/terms/o/one-belt-one-road-obor.asp>

¹⁸ China Pakistan Economic Corridor 2018 to 2020 web archive. Library of Congress. 2020. <https://www.loc.gov/collections/china-pakistan-economic-corridor-2018-2020-web-archive/about-this-collection/>

¹⁹ China's belt and Road already in retreat. Forbes. 2020. <https://www.forbes.com/sites/wadeshepard/2020/01/30/is-chinas-belt-and-road-already-in-retreat/#368566f05ebe>

²⁰ What is CPEC?. Obortunity. 2020. <https://obortunity.org/cpec-news/about-cpec/>

²¹ Li, Yang. China's free trade agreement Diplomacy. University of Adelaide. 2014. <https://digital.library.adelaide.edu.au/dspace/bitstream/2440/103486/2/02whole.pdf>

²² Alam, Khalid Mehmood. Li, Xueme. Baig, Saranjam. Impact of Transport Cost and Travel Time on Trade under China-Pakistan Economic Corridor (CPEC). Journal of Advanced transportation. 2019

²³ Khan, Muhammad Zaid Ullah. Khan, Minhas Majeed. China-Pakistan Economic Corridor: Opportunities and Challenges. Institute of Strategic Studies Islamabad. 2019

²⁴ Rahman, Saif. Shurong, Zhao. Analysis of Chinese national and security interests in China Pakistan Economic Corridor (CPEC) under the framework of One Belt One Road (OBOR) initiative. School of Political Science and Public Administration. 2017

of Pakistan. The government of Pakistan has decided three substitute highway routes which are - western route passing through Balochistan and Khyber Pakhtunkhwa; eastern route passing through Punjab and Sindh; the central route passing the entire country.²⁵ The project also includes building of various railway tracks and upgrading of existing ones. Since a large fraction of Pakistan's trade with China occurs through the sea route (97 percent through sea, 2 percent by air and 1 percent by land), CPEC would bring a drastic shift in the modes of transport wherein a significant portion of trade will be transported to the land route.²⁶

CPEC is planned in four different phases spread over a plan of 15 years and the debt to be repaid by Pakistan to China within a span of 30 years.²⁷ The first phase plans to improve the infrastructure in the transport and energy sector through the construction of power plants, railway lines and national highways to be completed by 2020. The first phase also targets the agricultural sector, industrial cooperation and generating employment through development of Special Economic Zones (SEZs). The medium term phase expected to be complete by 2025 will extend the benefits of the first phase to regions beyond the transit corridor. The final phase of the project plans to make South Asia a sustainable economic zone with global influence by 2030.

CPEC Proposed Timeline for Projects

Phases	Areas of investment
PHASE I (Early harvest Phase) (2015-18)	<ul style="list-style-type: none"> ◆ Enhancing the power generating capacity of Pakistan ◆ Improving the transport infrastructure of Pakistan through a transit corridor from Xinjiang to Gwadar, an Indian Ocean port in South Balochistan. ◆ Development of gas pipelines
PHASE II (Short term) (2018-20)	Provide a window for industrial cooperation, agriculture promotion, establish SEZs in Pakistan, create opportunities for joint ventures and create employment opportunities for the locals.
PHASE III (Medium Harvest Phase) (2020-25)	Extend the development of the initial phases to the regions that encompass beyond the transit corridor.
PHASE IV (Long Term) (2025-30)	Entirely accomplish the endogenous mechanism of sustainable economic growth and develop South Asia into an international economic zone of global influence.

²⁵ Alam, Khalid Mehmood. Li, Xueme. Baig, Saranjam. Impact of Transport Cost and Travel Time on Trade under China-Pakistan Economic Corridor (CPEC). Journal of Advanced transportation. 2019China-Pakistan Economic Corridor (CPEC). Journal of Advanced transportation. 2019

²⁶ CPEC: trade prospects. Dawn. 2020. <https://www.dawn.com/news/1304447>

²⁷ Cracking the phases and timeline of CPEC project. <https://www.askedon.com/cracking-the-phases-and-timeline-of-cpec-project/>

The China-Pakistan Economic Corridor Council founded in 2015 to jointly address the challenges arising in the CPEC projects has offices in Beijing and Islamabad, and its purpose is to assist with the implementation of projects.²⁸ Members of the Joint Working Committee (JWC) periodically meet to deliberate upon the progress made, and scrap and revise the projects to efficiently meet the objective of CPEC in letter and spirit. The 9th JWC was held in November 2019 where petroleum projects were discussed to be included in CPEC. According to reports²⁹, sustainable progress has been made in energy projects envisioned in the Early Harvest Phase (EHP). Prominent projects completed include 1000MW Quaid-e-Azam solar power plant (Bahawalpur), Thar Coal mining blocks and several other small energy projects which have been financially closed. Besides, other energy projects such as Sukki Kinari (870 MW) and Karot Hydropower Plant (720 MW) have made progress as planned. Additionally, significant progress has been made in the Infrastructure projects with Peshawar Karachi Highway being inaugurated in 2019. The Karakoram Highway project is nearing its completion and is likely to be completed soon. Work has also commenced on the Gwadar International Airport. The ground-breaking ceremony of Allama Iqbal Industrial city, a mega project of SEZ under CPEC was held in January 2020. On the Socio-economic front, development has been made in construction of reskilling and training centres, poverty alleviation programs etc.³⁰

In the second phase of CPEC, modernization of Pakistan's most important and strategically significant railway Mainline-1 (ML-1) was approved at an estimated cost of USD 6.8 billion between China and Pakistan in 2020. It has also been decided that majority (90 percent) of the project's cost will be financed by China. The project plans to connect the Gwadar port with other Pakistani cities through railway networks to flourish trade and transport. It will focus on the recovery and upgradation of the 1,872 km long railway track called Railway Mainline (ML-1) from Peshawar to Karachi into a double high speed lane. In order to meet the demand of freight traffic and cargo handling facilities, the railway project would also include Havelian dry port and upgrading of Walton Academy of Pakistan Railway.³¹

To address the concerns of debt sustainability in Pakistan by the International Monetary Fund (IMF), the project is designed in different phases as ceiling has been set on spending in each phase of the project by creating three different packages. The first package will undertake USD 2.4 billion (below IMF's ceiling of USD 2.5 billion) worth of construction work which is expected to be completed between 2022 and 2024, covering the 527-km long track between Peshawar, Rawalpindi and Lahore; the second package will have ceiling of USD 2.7 billion and will be completed by 2026 with a focus on upgrading the 521-km long track from Lahore to Hyderabad, and lastly the target of the third package will be to upgrade the 740-km Rawalpindi-Peshawar and Hyderabad-Multan track within a cost of USD 1.7 billion.³²

²⁸ Benefits and Risks of China Pakistan Economic Corridor. Center For Global Policy. 2016. <https://carnegietsinghua.org/2016/12/21/benefits-and-risks-of-china-pakistan-economic-corridor-pub-66507>

²⁹ CPEC Moving Ahead. Pakistan Today. 2020. <https://www.pakistantoday.com.pk/2020/08/18/cpec-moving-ahead/>

³⁰ One of China's most ambitious project becomes a corridor to nowhere. Economic Times. 2020. <https://economictimes.indiatimes.com/news/international/world-news/one-of-chinas-most-ambitious-projects-becomes-a-corridor-to-nowhere/articleshow/74452242.cms>

³¹ Pakistan approves CPEC's strategic \$6.8 billion ML-1 railway project. Gulf News. 2020. <https://gulfnews.com/world/asia/pakistan/pakistan-approves-cpecs-strategic-68-billion-ml-1-railway-project-1.73026570>

³² CPEC's strategic ML-1 project gets final nod. The Express tribune. 2020. <https://tribune.com.pk/story/2258237/cpecs-strategic-ml-1-project-gets-final-nod>

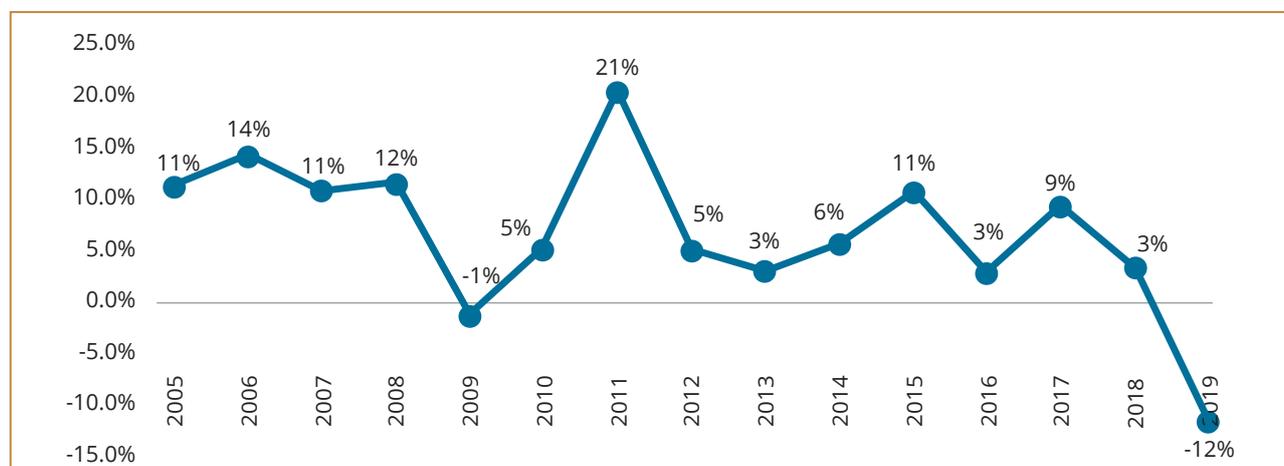
Even if the China-Pakistan Corridor has been described as an economic corridor, the final nature of the project is still far from being concluded and depends, to a large extent, on the decisions taken by China and Pakistan. Any huge project such as the CPEC aims at maximizing the benefits for the participating countries, and the spill over effects will also be realized by other nations. The project can improve the geographical connectivity of landlocked South Asian countries with China and Pakistan, hence providing a cheap and viable route for trade and transportation of goods. It will also provide easy access to energy and resource-rich markets of Central Asia and Afghanistan. However, if China and Pakistan will be able to strike a balance between the benefits and the burdens of the project is questionable.

3.1 Pakistan's Incentives from CPEC: Reviving the economy?

The CPEC has been repeatedly exhorted as a 'ground breaking' investment primarily for Pakistan. It is speculated that CPEC will improve Pakistan's stance in South Asia, and also benefit the country economically and socially. Pakistan greatly values the economic corridor and views it as mutually beneficial for both political and economic development.

Pakistan's economy has been under stress much before the Coronavirus pandemic hit the world. While Pakistan's global exports have increased by 48 per cent in the last two decades, from USD 16.1 billion in 2005 to around USD 23.8 billion in 2019, imports have gone up by 100 per cent in the same period, from around USD 25 billion to USD 50 billion. Hence, the trade deficit of the country has widened and reached at USD 26.3 billion in 2019 from USD 9 billion in 2005. Pakistan's failing economy can also be described through the continuously falling GDP growth rate which has declined from 9 percent in 2017 to 3 percent in 2018 and to -12 percent in 2019. Its Export to GDP ratio has decreased from 14 percent in 2011 to 10 percent in 2019, lower than its neighbouring countries such as Bangladesh (15 percent) and India (19 percent).

Figure 4: Pakistan's GDP Growth Rate, 2005-2019



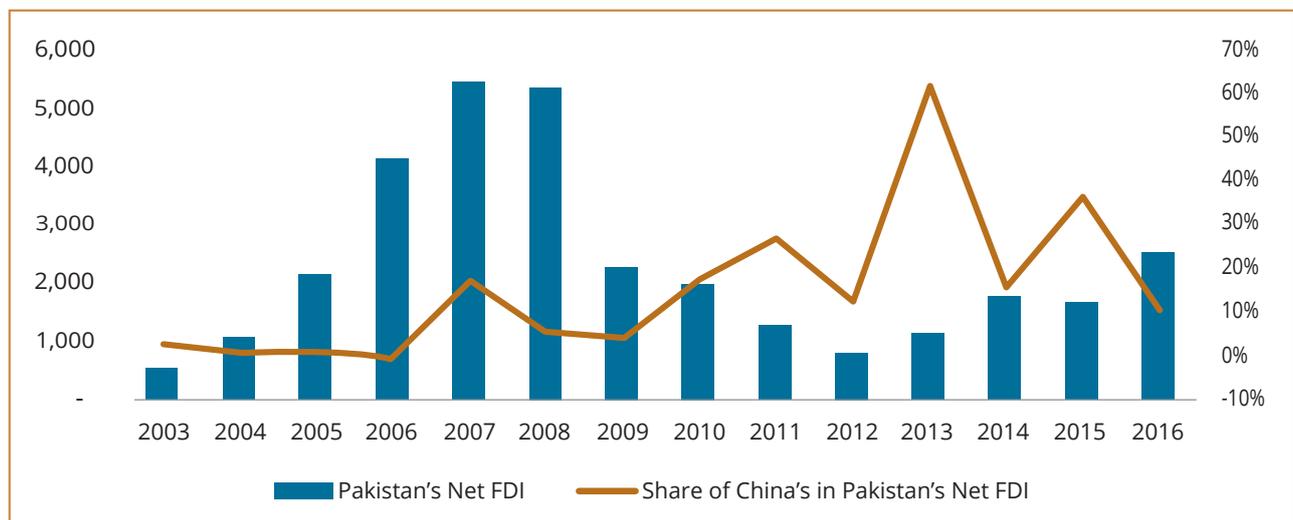
Source: World Bank database

³³ Power Sector Distortions Cost Pakistan Billions. The World Bank. 2018. <https://www.worldbank.org/en/news/press-release/2018/12/11/power-sector-distortions-cost-pakistan-billions>

Pakistan has been struggling with complex and deep energy and infrastructure problems. A World Bank report shows that the distortions in the power sector cost Pakistan as much as USD 18 billion in 2015 which is equivalent to 7 percent of its GDP.³³ The country is therefore trapped in a vicious cycle of energy deficit, poor infrastructure and lack of investment, all of which have led to a downward economic spiral also adversely impacting the social indicators of the state altogether. The energy and infrastructure bottlenecks have had indirect impacts on the social indicators by impeding business and attracting enough FDI in the country.

Based on a report by Pakistan’s Ministry of Planning, Development and Reform - Pakistan aims to progress from a lower-middle-income to an upper-middle-income nation by 2025. In order to achieve this goal, Pakistan will have to attract increasing amount of foreign direct investment from the world.³⁴ Notably, Pakistan’s FDI from China has seen a jump from 17 percent in 2007 to 62 percent of its total FDI in 2013.

Figure 5: Share of China in Pakistan’s Total FDI, 2003-2016 (USD million)



Source: UNCTAD database/ frontera.net

CPEC is seen as a ray of hope to save Pakistan’s failing economy as it is believed that the investments in the new network of roads, ports, and power plants would spur development and improve Pakistan’s macroeconomic condition.³⁵ The investment in infrastructure under CPEC will affect Pakistan’s economic growth through numerous channels. Majority of investment in energy infrastructure will help in alleviating Pakistan’s existing energy shortage. Pakistan is also expected to witness a boost in trade by improving competitiveness of firms and increase in exports of products, for example: CPEC will open up trade opportunities for Baltistan region of Pakistan for export of fresh fruits presently exported through air-cargo via Dubai. It will also improve rail and road connectivity with isolated areas in Karachi and Gwadar.

³⁴ The Benefits and Risk of China-Pakistan Economic Corridor. Carnegie Tsinghua Center for Global Policy. 2016. <https://carnegietsinghua.org/2016/12/21/benefits-and-risks-of-china-pakistan-economic-corridor-pub-66507>
³⁵ First Phase of CPEC to be completed by 2017. The Tribune. 2016. <https://tribune.com.pk/story/1060987/first-phase-of-cpec-to-be-completed-by-2017>

It is also widely believed that the borrowed Chinese investments and development of SEZs, the technological know-how, and the managerial expertise will diversify and bolster the manufacturing sector of Pakistan, thereby generating employment and increasing competitiveness in the international market.³⁶ Hence, if implemented with enough political will and impetus, developments from CPEC will bring many incentives for both the countries. In addition to the economic and social incentives, there are geo-strategic and security incentives as well for Pakistan. The geo-strategic position of Pakistan holds great significance as the country is bordered by emerging economies like China and India, and countries with abundant natural resources i.e. Afghanistan and Iran. Pakistan serves as an important link between China and Central Asia, South Asia, and the Middle East. Moreover, being surrounded by Arabian Sea in the south, it enjoys an important geostrategic location for trade in the Asian region. The development of road infrastructure and the Gwadar port through CPEC will provide an opportunity for Pakistan to become a key partner in regional trade. The economic commitment as huge as CPEC will not only improve the relations between China and Pakistan, but might also balance out the economic relations with neighbouring nations.

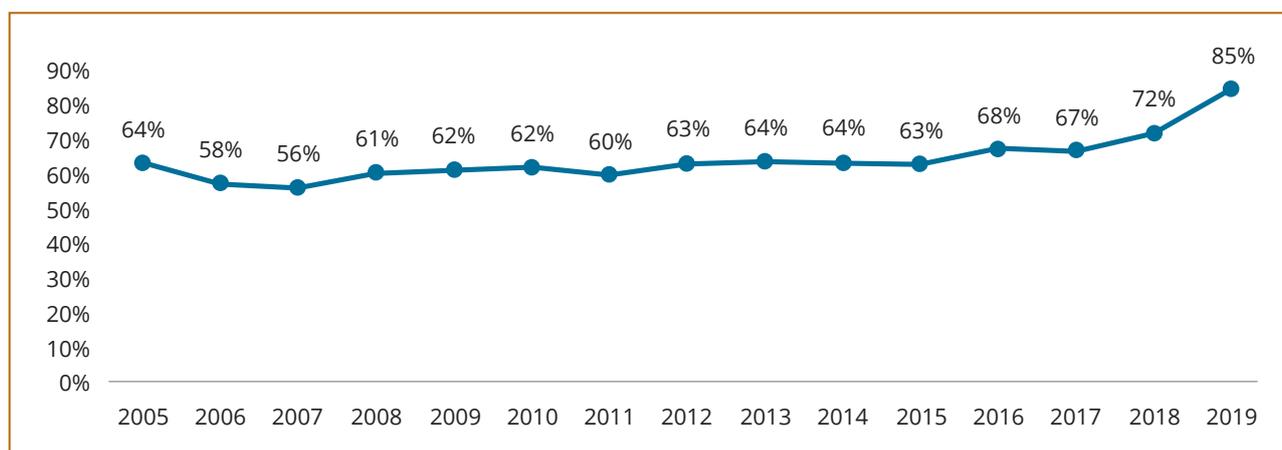
- ◆ The investments in energy sector through CPEC will generate as much as 17,000 MW energy in Pakistan and will provide a long-term solution to the energy crisis in Pakistan
- ◆ The Early Harvest Projects (EHPs) are expected to generate employment opportunities in Pakistan. According to estimates of Centre of Excellence of Pakistan – through projects under CPEC, more than 75,000 jobs have been created in the past five years in 22 infrastructure projects out of which 9 are complete
- ◆ Pakistan has shown interest in shifting its energy base to renewable energy projects being funded through CPEC. The 100MW Quaid-e-Azam solar power plant in Bhawalpur is the cleanest and largest source of energy generation in Pakistan
- ◆ In the orange line of Lahore Metro, USD 1.6 billion of investment through CPEC is speculated to serve 25,000 passengers daily
- ◆ The ML-1 railway rehabilitation and reconstruction will transform the 1,872 km long railway track and reduce the travel time significantly from Peshawar to Karachi
- ◆ China is investing USD 4.8 billion to develop Gwadar port as the busiest port in South Asia by 2022. Also, the Gwadar Smart Port City Master Plan around the port will attract foreign investments that have been laggard till now
- ◆ To catalyse commercial and economic growth, SEZs are being developed through CPEC, where companies enjoy business incentives and tax holidays to encourage foreign investment
- ◆ CPEC has promised investments in human capital through developing and reconstructing schools and hospitals in Pakistan. China-Pakistan Faqeer Primary School Project and Gwadar China-Pakistan Friendship hospital upgradation are some examples that can be quoted

³⁶ CPEC to generate more employment in Pakistan: Bajwa. Belt and Road News. 2020. <https://www.beltandroad.news/2020/02/06/cpec-to-generate-more-employment-in-pakistan-bajwa/>

3.2 Pakistan's Apprehensions from CPEC: More than a Debt-Trap?

Pakistan's economy has been struggling with repeated bailouts from IMF and debts from Gulf countries (the 13th bailout of USD 6 billion in 2019),³⁷ the debt and liabilities have increased significantly in the last two years, with a debt to GDP ratio as high as 85 percent in 2019.³⁸ With CPEC, there is an increasing likelihood for China's interest in Pakistan, from the construction of airports and highways to mega power projects and safe city projects, to translate into potential investments. However, Pakistan owes USD 6.7 billion in commercial loans to China, more than what it owes to the IMF. A 2017 report by IMF drew attention on the sheer size of Chinese debt for Pakistan. According to the report, Pakistan will have to pay USD 4.5 billion annually to China by 2024. Delays in such colossal investment might increase Chinese intervention in the internal affairs of Pakistan.³⁹

Figure 6: Pakistan's Debt to GDP ratio (2005-2019)



Source: Tradingeconomics.com

Chinese investment in Pakistan have followed a pattern of targeting the extractive sectors of energy and infrastructure. This has the potential to offset further the fragile balance of the sensitive regions, like Baltistan and Baluchistan through which the CPEC is expected to pass. The terms and conditions of Chinese loan to Pakistan on energy infrastructure under CPEC could exacerbate the current scenario in Pakistan. Chinese banks are going to levy an interest in the range of 2-5 percent. Apart from this, Pakistan will be obliged to purchase electricity from Chinese firms at the pre-determined rate. It has also pledged sovereign guarantee to Chinese firms. This will escalate the cost of electricity in Pakistan.⁴⁰

In order to promote monetary cooperation between their central banks, the two nations have agreed in January 2018 to use Chinese currency (Renminbi) as an official foreign

³⁷ Pakistan to accept \$ 6 billion bailout from I.M.F. The New York Times. 2019. <https://www.nytimes.com/2019/05/12/world/asia/pakistan-imf-bailout.html>

³⁸ Pakistan's total debt, liabilities rise to Rs35tr. The News. 2019. <https://www.thenews.com.pk/print/473930-pakistan-s-total-debt-liabilities-rise-to-rs35tr>

³⁹ Sheer size of CPEC portfolio appals IMF. Express Tribune. 2017. <http://tribune.com.pk/story/1578030/1-sheer-size-cpec-portfolio-appals-imf>

⁴⁰ India's CPEC dilemma: To participate or not to participate. East Asia Research Programme. 2018. <http://earp.in/en/indias-cpec-dilemma-to-be-or-not-to-be/>

currency for imports, exports, financing and investment activities. The adoption of Renminbi as an official currency means that China and Pakistan would be able to replace the US dollar for transactions in the CPEC project.⁴¹ In special economic zones, which are currently being constructed for the purpose of the CPEC projects, zone developers and zone enterprises can benefit from 10 years tax holidays on income and customs duties for the import of plant, machinery and equipment. However, the intent to provide this ease to the business community does not meet the ends as envisioned. Pakistan managed to attract FDI of USD 2.4 billion for the fiscal year 2017-18 out of which 61 percent were from China.⁴² Clearly, the industrial developments have failed to attract diversified investments from the business communities across the world.

Additionally, a concern regarding China's colonial interest as a rising power is also feared by many. It is believed that the purpose of the fibre optic project is not only digitising Pakistan but also aims at disseminating the Chinese culture and language through TV broadcasting with the cooperation of Chinese media.⁴³ They may impart technical knowledge and skills to Pakistani labour force but the lead role will be played by Chinese enterprises in each field. It is still unclear how the common Pakistanis and their firms will benefit from the long-term deal, but China's benefits in geopolitics, infrastructure, business, and agriculture are apparent.

3.3 Chinese Motives from CPEC: Strategic Ambitions or a Trade Facilitator?

The excitement and enthusiasm by Beijing clearly hint that BRI and CPEC have latent political, economic, and social significance for China beyond geopolitics and trade. BRI aims to improve the domestic growth of China and is also considered a part of the economic diplomacy strategy. It is believed that the economic activity of less developed regions such as Xinjiang will progress when connected with the neighbouring nations. Avenues for new markets for Chinese goods are also expected from the project as it will provide an access to the cost-effective routes to export materials. BRI is a huge venture including various infrastructure projects and China expects a greater return from its investments by offering low-cost loans to the participating nations.⁴⁴

China is the second-biggest economy in the world with increasing trade numbers - its total trade increased by more than 200 percent from 2005 to 2019. A huge share of China's trade

⁴¹ Pakistan Central bank allows Yuan based trade with China. The Economic Times. 2018. https://economictimes.indiatimes.com/news/international/business/pakistan-central-bank-allows-yuan-based-trade-with-china/articleshow/62350266.cms?utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst

⁴² The CPEC and Pakistan's foreign debt problem. China Us Focus. 2018. <https://www.chinausfocus.com/finance-economy/the-cpec-and-pakistans-foreign-debt-problem>

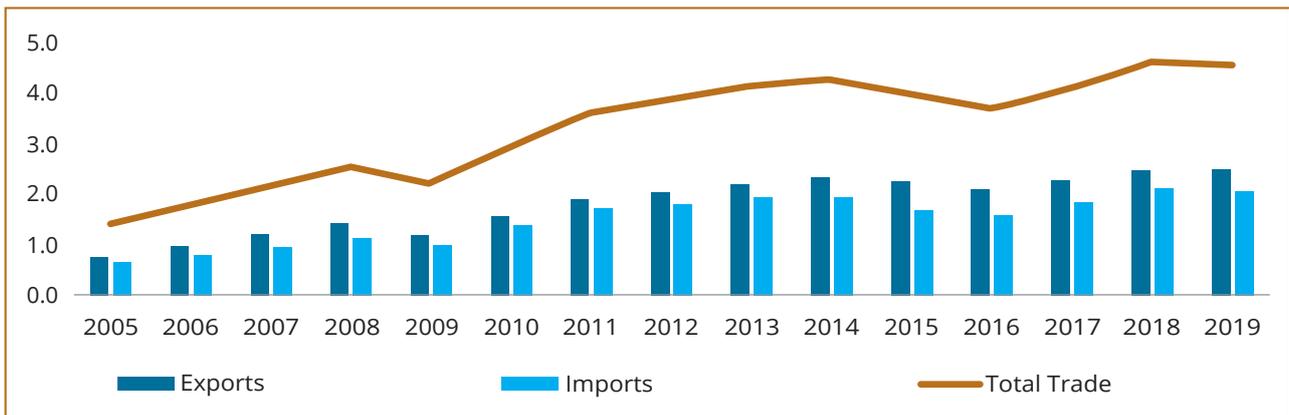
⁴³ Why Pakistan may end up as a Chinese colony with CPEC by 2030. Financial Express. 2017. <https://www.financialexpress.com/world-news/why-cpec-may-make-pakistan-a-complete-chinese-colony-by-2030/668856/>

⁴⁴ One Belt One Road. Investopedia. 2020. <https://www.investopedia.com/terms/o/one-belt-one-road-obor.asp>

⁴⁵ Alam, Khalid Mehmood. Li, Xueme. Baig, Saranjam. Impact of Transport Cost and Travel Time on Trade under China-Pakistan Economic Corridor (CPEC). Journal of Advanced transportation. 2019

is transported through the South China Sea (40 percent in 2016). The CPEC is described as a reasonable solution to China’s requirement for a short, secure, and low-cost trade route with Europe and the Middle East. CPEC is designed to connect China with Europe through Central Asia and the Maritime Silk Road route which is a part of this project will serve as a safe passage for trade through the sea from the Indian Ocean and the South China Sea. In other words, CPEC’s idea is to link China with almost half of the population of the world.⁴⁵

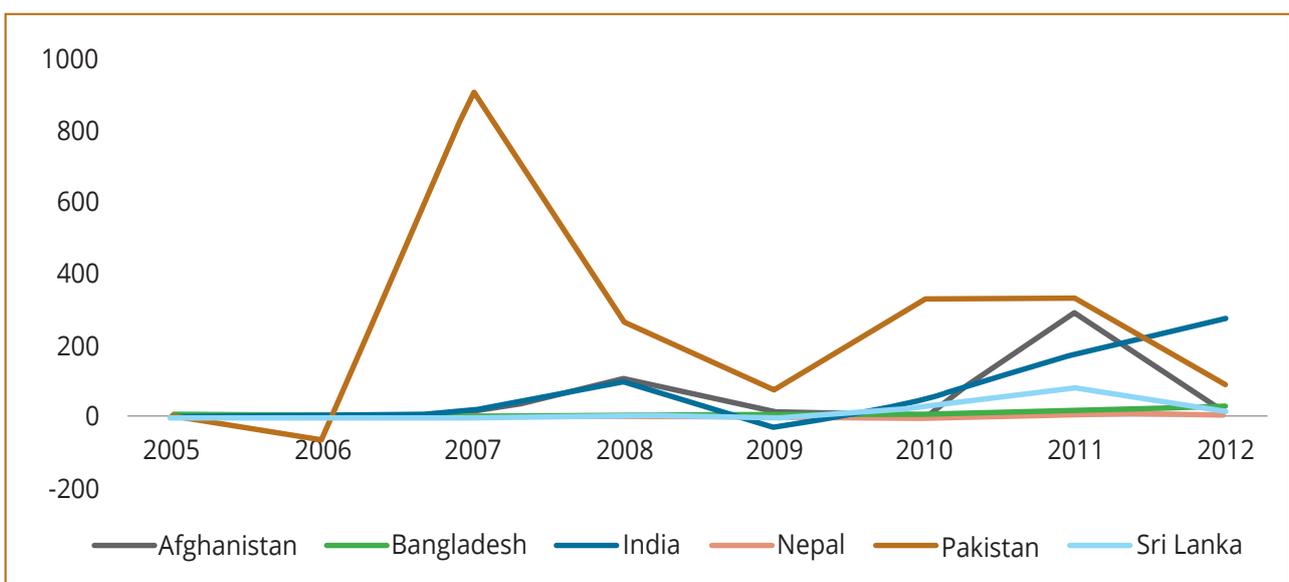
Figure 7: China’s trade with the World, 2005-2019 (USD trillion)



Source: ITC database

Although Chinese motives remain vague until the project’s near completion, however, the present social, economic, and political conditions indicate the possible intentions behind the multi-billion dollar project. China’s outward FDI to Pakistan has seen an increase from the last decade with the signing of CPFTA1 – increasing from USD 4 million in 2005 to a whopping USD 911 million in 2007 and an investment of nearly USD 200 million from 2008 to 2012, much higher than in other countries of the region like India and Bangladesh.

Figure 8: China FDI Outflows in South Asia, 2005-2012 (USD million)



Source: UNCTAD FDI/TNC Database

CPEC can be the means to promote regional integration and economic development of China. It can lead to the socio-economic development of underdeveloped regions of Western China and hence promote political stability amongst the population. Based on reports on China's economy - the growth rate of China has stagnated lately as a result of lack of innovation, political motives, poor investment and job losses among the less skilled workforce. It is widely perceived that the investment in CPEC will revive the stagnated growth through subsequent diversification and outsourcing and will pull the country out of the middle-income trap by capturing the higher ends of the global value chain. Moreover, China's energy resources have outdone its industrial growth rate. This has made Chinese growth rate vulnerable and dependent on crude oil and natural gas imports from the Middle East and Central Asia which pass through the contested region of Malacca Strait in the South China Sea. CPEC will provide an alternate land based route to directly import oil and natural gas from the Gulf and diversify Chinese options to trade.⁴⁶ It can also be an opportunity for China to utilize the amassed foreign reserves accumulated as a result of its exorbitant growth since it embraced manufacturing and industrialization in 1978. Other benefits to China from CPEC include:^{47,48}

- ◆ China will be in position to offer a shorter and economical trade route to many North and Latin American enterprises as they will be able to avoid the route through the Western Hemisphere
- ◆ CPEC would decrease China's trade route from the existing sea route of 12,000 kilometers to 2,000 kilometres
- ◆ Located at a mere 600 km distance from the Strait of Hormuz, Gwadar places China in close proximity to the Iran-controlled water channel, which supplies 35 percent of the world's oil requirements
- ◆ Around 80 percent of China's oil is transported from the Strait of Malacca to Shanghai, having a distance of almost 16,000 km which currently takes 2-3 months. However, with Gwadar becoming operational, the distance would reduce to less than 5,000 km
- ◆ Pakistan along with other BRI countries is interpreted as potential market to channelize the excess industrial production by China as its industries have outgrown the local demand
- ◆ Agriculture is a key area of CPEC as Pakistan's markets will become a major destination for agriculture produce from Western regions of China
- ◆ Development of fibre-optic connectivity between China and Pakistan for internet traffic and terrestrial development of broadcast TV

⁴⁶ Rahman, Saif. Shurong, Zhao. Analysis of Chinese national and security interests in China Pakistan Economic Corridor (CPEC) under the framework of One Belt One Road (OBOR) initiative. School of Political Science and Public Administration. 2017

⁴⁷ 5 ways India is going to be affected when CPEC changes world trade. The Quint. 2017. <https://www.thequint.com/voices/blogs/ways-india-going-to-be-affected-when-china-pakistan-cpec-changes-world-trade-gwadar>

⁴⁸ How will CPEC boost Pakistan economy. Deloitte. 2017. <https://www2.deloitte.com/content/dam/Deloitte/pk/Documents/risk/pak-china-eco-corridor-deloittepk-noexp.pdf>

⁴⁹ Rifaat, Hamza. Maini Tridivesh. The China-Pakistan Economic Corridor Strategic Rationales, External Perspectives, and Challenges to Effective Implementation. The Stimson Center. 2016

⁵⁰ Siegfried O. Wolf. The China-Pakistan Economic Corridor of the Belt and Road Initiative: Concept, Context and Assessment. Contemporary South Asian Studies. 2020

Geo-strategic incentives relying on the official documents of BRI and CPEC are based on the notion of 'equality and co-operation' and on China's foreign policy directive of non-aggression.⁴⁹ However, the project is widely assumed to be implemented with the implicit vision of Indo-Pacific dominance and alternate trade routes. CPEC through the Gwadar Port will therefore provide an alternative route to China. Given the rough terrain, the comparative advantage of a land route is still unknown.⁵⁰ CPEC can therefore be more than a mere economic corridor for China. The success of the project will come at a cost of huge investment, after which China might rise as a new forerunner in South Asian dynamics.

3.4 India's Stake in CPEC: Opportunities Missed or Fears Allayed?

China's engagement with India's immediate neighbours through corridors such as the CPEC is believed to have certain benefits as well as concerns for India and other nations. The most important benefit from the success of CPEC will be the infrastructure development which will help not only India but also other parts of the region. The project can provide a way to help in financing the country's domestic infrastructure. India can accrue notable economic benefits in the North-Eastern part of the country which is geographically distant but consists of several important cross-border trading routes. Further, if India engages with China and Pakistan in CPEC, it will find an alternate route for Chinese imports through the Gwadar port than trading through the Indian Ocean as doing currently. This will increase the trade between India and China and even reduce the cost for Chinese imports since India can bargain with China on its reduced transport cost. This will serve as an opportunity for Indian goods to compete with Chinese goods in the Pakistani markets thereby improving competition in Pakistani markets and reviving the India-Pakistan trade which has lately been stalled amidst rising tensions. Despite these potential benefits, Indian opposition to CPEC appears to be more dominant.⁵¹

India's prime concern is China's growing presence in the region will be used to advance its strategic interests. India does not oppose the infrastructure development in the South Asian region but has major concerns regarding the deliberate consequences of China's economic initiatives. One significant example is the Hambantota port of Sri Lanka, the first phase of which was opened in November 2010 and can be described as China's ambitious 'debt trap' diplomacy.⁵² The port was built using loans from China which Sri Lanka was unable to pay due to high-interest rates. This resulted in an escalating debt burden on the country. The port failed to gain traction because of the Colombo port in the proximity serving the purpose. Ultimately, in 2017, the Sri Lankan government had to lease the port to China for ninety-nine years. The port is not the only grandiose investment made by the government in the city of Hambantota. Besides the port there is a cricket stadium, a highway and an international airport.⁵³

⁵¹ India's opposition to CPEC on shaky grounds. Asia Times. 2020. <https://asiatimes.com/2020/04/indias-opposition-to-cpec-on-shaky-ground/>

⁵² China's new Silk Road or debt-trap diplomacy?. Global Risk Insights. 2019. <https://globalriskinsights.com/2019/05/china-debt-diplomacy/>

A question that has been widely asked - Is Pakistan following Sri Lanka's footsteps in its increasing involvement with China? The Gwadar port envisioned under CPEC and Hambantota represent some astounding similarities. Gwadar is a modern outpost lying in a rural setting that has a low population density to sustain the business demand, just like it happened in the case of Hambantota. Moreover, developing infrastructure as grand as Hambantota or Gwadar requires continuous cash flows and administrative competence which is unfortunately not present in the case of Pakistan given its recent economic trends.⁵⁴ The amount of investment by China in CPEC is far greater as compared to Hambantota. Pakistan, therefore, has to keep in mind that it is not just infrastructure development, but the viability and sustainability that will lead the country to the path of progress.

India worries that through the development of the Gwadar port in the Arabian Sea, China plans to reduce its dependence in the Indian Ocean region which has been the primary route for the movement of Chinese trade (80 percent happens through Malacca Strait).⁵⁵ It is also a concern that China's growing outreach in South Asia will create a structure inclined towards meeting its interests of becoming a global power.⁵⁶

3.5 CPEC Comparative Assessment with Similar Projects

There is a widespread consensus on CPEC being a transformative infrastructure project for the economy of Pakistan. Although there is enough research on its geopolitical implications, there is little research on the likely economic outcome of CPEC. This is primarily because the project is spanned over a timeline of 15 years and the results are yet to be quantified and assessed.

To understand the potential benefits that a project like CPEC might bring in for the host countries, this section tries to draw examples from previous such foreign-funded projects mainly are Panama and the Suez Canal. Although these projects were limited to economic transit and trade and were not as diversified as compared to CPEC, yet they provide enough evidence to get a whiff of the ends CPEC as a project might meet.

The Panama project connects the Atlantic and Pacific Oceans through the Isthmus of Panama. The project was completed by the US in 1914 and saves around 8,000 nautical miles of distance and 30 days of journey between the Pacific and the Atlantic Ocean compared to the previous alternate route of Cape of Good Hope.⁵⁷ To politically stabilize the route for trade, two treaties were signed between the US and the Panama.⁵⁸ The Panama has therefore witnessed unprecedented level of growth in GDP with added toll revenues in Panama's net revenues before the year 2000.

⁵³ India's answer to the belt and road: A road map for South Asia. Carnegie India. 2018. <https://carnegieindia.org/2018/08/21/india-s-answer-to-belt-and-road-road-map-for-south-asia-pub-77071>

⁵⁴ How China got Sri Lanka to cough up a port. New York Times. 2018. <https://www.nytimes.com/2018/06/25/world/asia/china-sri-lanka-port.html>

⁵⁵ Evers, Hans-Dieter. Gerke, Solvay. The Strategic Importance of the Straits of Malacca. SSRN Electronic Journal. 2006

⁵⁶ Does the China Pakistan Economic Corridor Worry India. Al Jazeera. 2017. <https://www.aljazeera.com/indepth/features/2017/02/china-pakistan-economic-corridor-worry-india-170208063418124.html>

The Suez Canal - a private enterprise, with a majority of French shareholders constructed the Suez Canal in 1869, linking the Mediterranean Sea with the Red Sea through the Isthmus of Suez. The Suez Canal comprises 3 percent of Egypt's GDP⁵⁹ and its contribution is likely to increase significantly post foreign investments and construction of the new Suez Canal. It can save up to nine days and reduce 3,000 nautical miles in distance.⁶⁰ The canal has been the bone of contention in 1956 when the Egyptian government nationalised it and Israel, France, and Britain declared a war on Egypt. The canal has been the primary route for international trade but has failed to attract any foreign investment in Egypt because of the increased interference of the armed forces in business policies of the state.⁶¹ CPEC as a project when compared to the other foreign funded infrastructures can have similar consequences. Pakistan must thoroughly draft its policies in social security to reap the benefits of holistic and equitable development from CPEC.

⁵⁷ Ahmad Rashid Malik et al., China-Pakistan Economic Corridor A Game Changer.

⁵⁸ Andrew Zimbalist and John Weeks, Panama at the Crossroads, Economic Development and Political Change in the Twentieth Century. University of California Press, 1991

⁵⁹ Economy of Egypt. Fanack. 2017. <https://fanack.com/egypt/economy/>.

⁶⁰ Importance of the Suez Canal. Suez Canal Authority. 2017

⁶¹ Khan, Hanif Ullah. China Pakistan Economic Corridor (CPEC): Benefits for Pakistan and comparison with Suez and Panama Canals. 2017.

4.1 Is Administrative Efficiency a Pre-requisite? Lessons from the German Industrialisation

To reap the economic benefits of CPEC, Pakistan needs to carefully articulate its domestic policies. The German industrialization presents a similar precedent.

The German industries were quite primitive before the development of railways in the 1830s and incompetent in producing industrial goods such as rails and locomotives. For example, in 1835, more than 90 percent of wrought iron was produced in small charcoal-using furnaces. But as railways developed, the substitution of foreign imported goods began and Germany started developing its own industries with improved technology while those already existent increased their efficiency. By the 1850s almost all the locomotives except a few from Austria were supplied from Germany. However, one aspect that needed attention in the industrialisation process was the role of the state, through effective tariff policies, subsidies investment, and public-private participation. To catch up with the modern British technologies Germany needed imitation and borrowing which was taken care of by German manufacturers studying in France and Britain and leading investors who sought investment in the Ruhr and Rhine coal reserves of Germany.

According to a study by Matthew McCartney, post the French Revolution of 1789, France was politically and economically advanced than Germany and thus incorporated a wide array of reforms to facilitate coal mining. Although the Rhine valley became independent from France in 1815, the institutional reforms that abolished serfdom, feudalism, and guilds remained still. The Zollverein or German Customs Union abolished tolls between various German principalities and made it into a common market. To promote trade, Germany removed the protectionist barriers to make the transport of raw material and finished goods cheaper which also benefited the other emerging industrial parts of the country. The German unification in 1871 sped up the industrialization process. The tariff policies introduced in 1879 protected and promoted the local business and labourers and the introduction of social welfare schemes by Bismarck established political stability and trust in the government. Investment in education and skill development focused on technical areas of industries such as electrics, physics, and chemistry that skilled the workforce.

The transformative infrastructure indeed brought in sustained economic growth for Germany, but one must not ignore the fact that it was catalysed and made efficient by the state intervention. To reap similar benefits as Germany, Pakistan must focus on trade promotion policies and direct its attention towards infrastructure development which is a prerequisite for the industrialisation process. Therefore, a transformative infrastructural project like CPEC requires an effective and efficient government participation to promote growth of its

domestic industries and prevent leakage overseas. Unfortunately, there is increasing evidence in Pakistan of deteriorating authority and legitimacy of the state. The Global Competitiveness Index (published by the World Economic Forum) ranked Pakistan 110 out of 140 countries in 2018. The Corruption Index (published by Transparency International) ranked Pakistan 117 out of 180 countries. Therefore, to take advantage of the CPEC project, Pakistan needs to have a wide array of domestic reforms in place. Else, there are numerous examples of splendid infrastructure projects in the history, like the Olympic infrastructure, the optimistic promise that ended up isolating themselves from the rest of the economy.

4.2 Energy Sector of Pakistan: How will CPEC Power it up?

Energy deficits are a major obstruction in Pakistan's economic growth, CPEC can be a promising investment to pull Pakistan out of the energy deficit trap.

A developing country such as Pakistan requires an efficient and sustainable energy infrastructure to walk down the path of envisioned economic growth and socio-economic development. Despite the fact - the energy crisis of Pakistan is not hidden with over 51 million (27 percent) of the population living without electricity - according to World Energy Outlook (2016) statistics.⁶² Those with access suffer from frequent blackouts and load shedding (6-8 hours per day in urban areas) and consequently, 144 million out of the 185 million do not have reliable access to energy.⁶³

The energy crisis of Pakistan started in the 1990s when the populist regimes decided to shift their reliance from hydropower projects to fossil fuel-powered plants. This snowballed into a major power crisis in the 2000s when the prices of oil skyrocketed and hence the cost of production of electricity increased. As a result, the circular debts in the power sector escalated to PKR 1,000 billion, primarily because of the transmission losses (which account for 18.3 percent of circular debt),⁶⁴ poor recovery and mismanagement (subsidies and electricity theft) among other factors. Moreover, policymakers have made little efforts to diversify their energy supply and shift from expensive oil imports to cheaper renewable energy alternatives (Pakistan's reliance on oil imports is 24 percent). The energy diversification in Pakistan involving 64 percent Thermal, 30 percent Hydropower, and 6 percent Nuclear energy, does not meet the needs of environment conservation.⁶⁵

The CPEC, therefore, envisages bridging the energy deficit in Pakistan through Early Harvest Projects (EHPs). Out of the 21 estimated energy products that are to be developed are expected to produce a power output of about 17,000 MW quite above the 2015 shortfall of 4,500 MW.⁶⁶

⁶² International Energy Agency. 'WEO - Energy Access Database'. 2016. <http://www.worldenergyoutlook.org/resources/energydevelopment/energyaccessdatabase/>

⁶³ Awan, Umul. 'Potential for Financing Off-Grid Solar Devices through Pakistan's Microfinance Industry'. Lighting Asia. 2016

⁶⁴ Powering the Powerless in Pakistan. The Diplomat. 2018. <https://thediplomat.com/2018/11/powering-the-powerless-in-pakistan/>

⁶⁵ Energy Crisis Under CPEC. CPEC Bulletin. 2020. <https://cpecbulletin.com/2020/07/22/energy-crisis-cpec-2/>

The direct benefits speculated by levelling this energy deficit of Pakistan, are employment generation and increased competitiveness in the global market through increased productivity. Also, the increased reliance on renewable energy with China investing in such energy projects will be an added benefit. It is predicted that the 16 Early Harvest Projects (EHPs) will generate employment of around 73,728 where the share of local employment will increase gradually as skilled and semi-skilled labour increases with each project completion and skill development initiatives by Beijing and Islamabad.⁶⁷

Pakistan must still be worried about the debt trap that such huge investments might push the country into. The energy projects under CPEC will be accorded to private independent power producers but not the state enterprises of China or Pakistan. These projects will be financed by the EXIM Bank of China and Pakistan will be obliged to purchase the generated energy at pre-negotiated rates.⁶⁸ This might further push the Pakistani debt-laden economy into a downward spiral if mismanaged through poor policymaking and budgeting by the state.

⁶⁶ Energy Crisis and CPEC contribution. Pakistan and Gulf Economist. 2018. <https://www.pakistangulfeconomist.com/2018/10/08/energy-crisis-and-cpec-contribution/>

⁶⁷ Rashid, Shahid. Zia, Muhammad. Waqar, Shuja. Employment Outlook of China Pakistan Economic Corridor: A Meta Analysis. Centre for Excellence- China Pakistan Economic Corridor. 2018

⁶⁸ CPEC answer to energy crisis. Pakistan Observer. 2020. <https://pakobserver.net/cpec-answer-to-energy-crisis/>

The ongoing pandemic and consequently, the economic slowdown due to decreased demand and slowed production is an evident reality with countries around the globe depicting falling growth rates. Such a crisis has also impacted the CPEC project which is dependent on the local workforce as well as the migrant Chinese workforce for its completion. Pakistan is in constant discussion with Chinese government and Chinese companies on the health and safety of the labour force. Pakistan has implemented double quarantine measures for the Chinese workforce returning to Pakistan and signed a Memorandum of Understanding (MoU) for co-operation in healthcare, education, technology and agriculture for smooth completion of the project. Both the countries are persistent in continuing the construction with increased precautionary measures as Pakistan can't afford an economic shock, given the already deteriorating condition of its economy even before the COVID-19 pandemic hit the world.⁶⁹

The CPEC, as a concept, paints a rosy picture for both China as well as Pakistan through an estimated investment of USD 62 billion in infrastructure development, industrialization, construction of roads, railways and ports etc. The FDI outflows from China to Pakistan have risen significantly post CPEC, which has also delivered FDI flows in sectors that form the basis for growth of any developing nation (power and transport), especially at a time when no potential investor other than China was willing to spend given the economic condition of Pakistan. On the other hand, China has not limited CPEC as merely an infrastructure project but has diversified it into the field of social development as the means to promote the development of regions of Western China. This has been projected to positively impact the Chinese industries by absorbing the excess production outgrowing its demand in the Chinese markets and an opportunity to invest the amassed foreign reserves of the country.

However, Pakistan's rising trade deficit with China from USD 0.7 billion in 2003 to USD 10.4 billion in 2019 shows an increased dependence on Chinese imports. Pakistan's imports from China have seen a jump from USD 1 billion in 2003 to USD 12.4 billion in 2019. This raises concerns about poorly managed and diversified exports base of Pakistan as exports of the only product category Cotton constitutes around 40 percent of its exports to China. Moreover, the lack of political will, rising militancy, and increased corruption are some of the additional issues faced by Pakistan. It is believed that in order to attain maximum benefits from CPEC, the government of Pakistan needs to put in place a wide array of domestic reforms so that it does not become a victim of debt-trap diplomacy.

It is also feared by other countries that China might utilise such huge investments as a means to extract cutting edge technologies through forced agreements. Instead, China should set an example by providing alternate routes through CPEC to reinvigorate international trade, especially when the authority of multilateral institutions is put into question during the pandemic.

⁶⁹ Impact of Covid-19 on CPEC. Business Recorder.2020. <https://www.brecorder.com/news/588492>

India's fears and concerns that Gwadar will become the economic hub of the world trade and other economic activities after its completion in 2030. These concerns should not be discredited and must be reflected upon by both China and Pakistan in their bilateral talks to engage India in the project and allay its apprehensions. Meanwhile, India can explore the socio-economic benefits that being a part of the project might entail through reduced trade costs with China and increased trade with both countries.

The impact of CPEC largely depends on the decisions taken by the countries involved along with the geopolitical climate. China and Pakistan need enough political will to make the project a success keeping aside their individual motives. The transformative infrastructure as big as CPEC can bring in vast economic opportunities for Pakistan, but if mismanaged, can prove to be just another transit route to facilitate China's trade. Pakistan needs to effectively envision its development and pursue industries with comparative advantage for the 'take-off' and the sustained growth henceforth. CPEC can be a win-win situation not only for China, Pakistan, or India but for other South Asian nations as well, providing them an alternate route to trade with the world.

What CPEC offers to Pakistan?

Incentives

Economic development focusing on transport infrastructure, industrial development, energy and Balochistan's strategically located Gwadar port.

- ◆ Agricultural modernisation and production, and job creation
- ◆ 17,000 megawatt of electricity to the national grid of Pakistan
- ◆ Building of various railway tracks and upgrading of existing ones
- ◆ Development of Gwadar port making Pakistan the hub of regional economic activity

The development of highways, railway lines, gas pipelines and economic zones under CPEC can potentially make Pakistan economically strong and self-reliant.

Concerns

- ◆ Pakistan owes USD 6.7 billion in commercial loans to China, more than what it owes to the IMF. A 2017 report by IMF draws attention on the sheer size of Chinese debt for Pakistan (USD 4.5 billion annually by 2024)
- ◆ Delay in debt repayment might increase Chinese intervention in the internal affairs of Pakistan
- ◆ Pakistan will be obliged to purchase electricity from Chinese firms at the pre-determined rate. This will increase the cost of electricity in Pakistan
- ◆ Additional concerns regarding China's colonial interest as a rising power – for example, dissemination of Chinese culture and language through TV broadcasting in Pakistan

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Bureau of Research on Industry and Economic Fundamentals (BRIEF) is a New Delhi based research and policy think tank with a focus on international trade and regional cooperation in South Asia. Over the last few years, in order to strengthen the dialogue on economic engagement between India and Pakistan, we have initiated parallel programs focusing on multiple strands of economic cooperation between India and Pakistan including both mainstream bilateral trade and cross-Line of Control trade, and other Confidence Building Measures (CBMs) between the two countries. As a part of these programs, the main focus of our work is building research repository, creating positive constituencies, engaging and interacting with key stakeholders at multiple levels, and developing cross-border linkages – that help shape a positive narrative about India and Pakistan, nationally, bilaterally, as well as at a regional level in South Asia.

This paper – which assesses the efficiency of the CPEC project as a facilitator of economic, social and geopolitical relations between China and Pakistan – is an outcome of one of our ongoing programs “Building Bridges, (Re)Connecting Communities” in partnership with Conciliation Resources.



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