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CPEC, Economics and Options for India

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We all have heard enough of the US$ 46 billion Chinese investment project in Pakistan – the CPEC (China-Pakistan Economic Corridor). It is the biggest foreign investment committed by China. China has undertaken six such economic corridor projects in Asia under its "One Belt, One Road" initiative. Under the CPEC project: (i) a deep sea port will be developed in Gwadar, Baluchistan; (ii) a network of rail/roads will be built from Gwadar to Kashgar in China's northwestern autonomous region of Xinjiang; and (iii) China will set up power projects in Pakistan to overcome the latter's energy shortage.

Key Points

1. China has undertaken six such economic corridor projects in Asia under its "One Belt, One Road" initiative. Under the CPEC project:
   - a deep sea port will be developed in Gwadar, Baluchistan;
   - a network of rail/roads will be built from Gwadar to Kashgar in China's northwestern autonomous region of Xinjiang; and
   - China will set up power projects in Pakistan to overcome the latter's energy shortage.
2. For China this save's on transportation cost (due to the short distance between Gwadar and Xinjiang—all Chinese exports will go by this route instead of the longer sea route). Also to have an alternate route to the long sea route that passes through the Malacca Strait (that can be blocked by the Indian or US Navy during a time of crisis).
3. "Make in India" initiative can help making the CPEC economically less attractive. If we improve our rail/road/port infrastructure, bring land/tax reforms, resolve power supply issues and remove bureaucratic hurdles to make the environment more investment/business friendly, we can successfully move manufacturing from China to India.

CPEC: Pakistan's National Project

The CPEC has been projected in Pakistan as a magic wand to resolve all the issues in that country as it would bring the much needed foreign investment, business and prosperity. Over 30 news channels of Pakistan have been assuring their audience that a golden age is just around the corner. They all have been projecting that India is deeply worried about the immense benefits Pakistan will enjoy from this project. It was even declared on the Pakistani news channels that India's premiere spy agency, the Raw and Analysis Wing (R&AW) has created a special desk with a budget of millions of dollars, to destroy the CPEC project!

Gen Raheel Sharif (Chief of the Army Staff, Pakistan Army) has taken a special interest in the project. He has made several trips to China where he discussed the CPEC, its progress and its security along with other defence related matters. The Pakistan Army has raised a `Special Security Division` headed by a Major General. It is a force of around 15,000 soldiers [9 composite infantry battalions (9,000 personnel) and six Civilian Armed Forces (CAFs) wings (6,000 personnel)]. There are around 7,000 Chinese working on the CPEC in Pakistan, so it means two security personnel for every Chinese worker. Gen Raheel Sharif has stated a number of times that the Pakistan Army will ensure that the CPEC gets completed on time and without any hindrance. Here is what he said recently, "Hostile intelligence agencies averse to this grand project, especially the Indian intelligence agency RAW ... [are] blatantly involved in destabilising Pakistan", and that "we are totally aware of all the campaigns against the corridor and I vow that the security forces are ready to pay any price to turn this long cherished dream into reality."

Pakistani federal ministers have been saying that this "game changer" project will not only change the destiny of Pakistanis but of over three billion people of the area! By three billion, they refer to the entire population of India, China, Pakistan and Bangladesh. In a nutshell, the "CPEC and bright future of Pakistan" hype is at an all-time high.

In short, everyone in Pakistan – the media, military, politicians, non-state actors (Hafiz Sayeed)—are with the CPEC.

But a few are raising their voices in Pakistan about the economic viability of the CPEC. The CPEC project has been shrouded in secrecy since its beginning. The Government of Pakistan did not share detailed information with the media or the public. Anything linked to the CPEC project (even the Orange Line Metro Train Project), has been declared a matter of national security, whose details can be shared with only the Chairman of the Senate.

Economic Aspects of CPEC

It is important to understand that the CPEC: (a) is not a complete US$ 46 billion investment. $46 billion is the total cost of the project and Pakistan will have to invest its share in the project; (b) the Chinese investment is not the direct investment of the Chinese government—it is private Chinese investment funded by the Chinese government. To do so, the Chinese government has instituted banks and funds (Silk Road Fund Co. Ltd) to provide loans to Chinese companies that will, in turn, invest the loaned amount in different projects. This ensures that the Chinese government gets its targeted return on the investment.

The US$ 46 billion project has two major parts: (i) US$ 35 billion investment in the power sector, where Chinese companies will lay gas pipelines and set up coal, wind, solar and hydropower plants; and (ii) US$ 11 billion investment in infrastructure projects i.e. building the road corridor from Gwadar to Kashgar.

Pakistan will have to invest its share in different projects. Its share in energy projects is approximately 20 percent and in infrastructure projects, it is 50-60 percent. In total, Pakistan will have to manage around US$ 15-20 billion. Considering the current condition of the Pakistan economy where the `debt to GDP (Gross Domestic Product) ratio is touching 65 percent, with total foreign debt touching approximately US$ 70 billion, it will be difficult to arrange an additional loan for the CPEC projects.

Table 1

Project	Total Cost	China's Share	Pakistan's Share	China's Return on Investment
Infrastructure	$11 billion	40-50%	50-60%	Not known
Energy	$35 billion	80%	20%	27.2%

Moreover, China will build coal-based energy plants worth US$ 6 billion in Sindh, Punjab and Baluchistan. It is important to note that China is decommissioning such coal-based power plants in China and will not use existing ones beyond 2020. Pakistan is also a signatory to the Paris Climate Agreement and the issue of eco-dumping and increased carbon footprint will make it difficult for Pakistan to take loans from the Western countries or institutions.

Even if the funds are obtained from somewhere, the invested money must generate enough revenue to allow the state to pay interest as well as the principal amount. Federal Finance Minister Ishaq Dar has already informed the Senate that the loans taken for the CPEC will pose a serious challenge to Pakistan's economy.

Why so?

Economic Viability of Energy Projects

China has played the game in its best interest.As per Hussain Ahmad Siddqui, retired Chairman of the State Engineering Corporation, Ministry of Industries and Production,for the money invested in the energy sector, China has asked Pakistan for 27.2 percent return on the equity. Sinosure (China Export and Credit Insurance Corporation), that has insured all the Chinese loans against non-payment risks, has signed a framework agreement with the Water and Power Ministry to obtain sovereign guarantees. Both countries have already decided how much electricity will be purchased by the state of Pakistan and for how long. A 27.2 percent return on equity means that the end-user (Pakistani people) will have to pay more for the electricity. Pakistan has already imposed an additional CPEC security tax of 1 percent in all electricity bills. It sounds strange that though this CPEC project will take another 10-15 years to be completed, the public has been made to pay the security tax now.

Pakistan already has the highest electricity rates in South and East Asia. And that is directly impacting its industry, especially exports, which are down by 20 percent as per the Pakistan State Bank's July 2016 figures. Energy produced from the CPEC power plants will be all the way costlier. As Pakistan is bound by the agreement to buy electricity from the project, it will not have any choice. Either the common Pakistani will bear the cost or the government will have to subsidise the electricity. This will eventually increase the country's external/ internal loans and circular debt

Economic Viability of Gwadar-Kashgar, Xinjiang Road

Most analysts think that the road from Gwadar is being built for two main reasons:

- To save on transportation cost (due to the short distance between Gwadar and Xinjiang—all Chinese exports will go by this route instead of the longer sea route).
- To have an alternate route to the long sea route that passes through the Malacca Strait (that can be blocked by the Indian or US Navy during a time of crisis).

Currently, China is the manufacturing hub of the world—almost the entire world imports Chinese made goods. The only major commodity that China imports is crude oil from the Gulf countries. If this road is being considered as a main route of import or export by China (because of its short distance in comparison with the longer sea route), then it will not make much economic sense as China's industrial hubs are in eastern China from where the goods will have to be transported by truck/train all the way to Xinjiang and then turn south towards Gwadar. From Gwadar, the goods would be loaded onto ships for their final destination – most likely the European/ African countries. This land/sea transportation mode would be a costly proposition when compared with the direct transportation of goods through the sea lanes. Shipping goods directly from the eastern Chinese sea ports in ships will be 8 to 10 times cheaper.

Once the project is near completed, China might consider transferring some of its polluting industries to Pakistan. China would do so to reduce its carbon footprint. If this actually happens, it will put Pakistan in a difficult situation because of the Paris Climate Agreement.

The Gwadar-Xinjiang road appears to have been envisaged as **an alternate route** to the Malacca Strait sea lanes, which are being used for Chinese imports and exports. In the case of any hostility, the US or Indian Navy can block the Malacca Strait in no time, causing considerable damage to the People's Republic of China. Perhaps this explains China's lower allocation to the infrastructure project (US$ 11 billion) compared with the higher share of Pakistan (50-80 percent) in this project. China's share in energy related projects (US$ 35 billion), **where 27.2 percent returns have been given a sovereign guarantee** by the Pakistan government, is approximately 80 percent.

It would also be used to trade with the Central Asian countries. The road from Kashgar to Gwadar has two routes – the Eastern and Western. The Western route (that passes through the entire length of Baluchistan) can be utilised later to connect to the Central Asian countries. China wants to exploit the energy reserves of the Central Asian countries to meet its energy needs and will build oil and piped gas lines from these countries all the way to China through Pakistan Occupied Kashmir (POK) which will run along the CPEC.

But time will prove the economic viability of the usage of the rail/road network for trade with the Central Asian countries compared to shipping the manufactured goods to the European/African countries through Gwadar port.

Options for India

When the CPEC was getting signed in 2014, India registered its official objection because the proposed road passes through POK – a territory that belongs to India and was illegally captured by Pakistan in 1947. This objection was ignored and work started on the project.

India's strategic concerns over the CPEC cannot be ignored. There are already reports of Chinese troops in Gilgit-Baltistan. Once the project is complete, one cannot rule out the possibility of Chinese encirclement of India during any hostility. So far, we have been discussing India's capability to fight on two fronts but such encirclement by the Chinese troops will make it an even more difficult 2+ front situation. India will have to deal with the enemy all the way from Arunachal Pradesh, Ladakh, Kashmir Punjab, Rajasthan and Gujarat. Pakistan will definitely hop on to the Chinese bandwagon.

The current government's policy of isolating Pakistan in the world community is correct and is paying dividends. Pakistan's economy is already at its weakest point. There is no American aid and Chinese investment has come with an agreement of great returns. If there is no industrial growth in Pakistan, payment of loans and the Chinese investment return will make its economic condition even worse.

Apart from declining exports, there are two major pillars of the Pakistani economy: remittances from Pakistanis working overseas, and loans. Pakistan has stopped getting aid for the Kashmir cause. Its diplomatic isolation from its traditional donors like the UAE and Saudi Arabia has dried up that tap as well (it is important to note that when Nawaz Sharif came to power in 2014, Saudi Arabia ***gifted*** US$ 1.5 billion to Pakistan). Thousands of Pakistani workers have been thrown out from Saudi Arabia. As per a report in *Pakistan Today*, Pakistani remittances have already dropped by 36 percent.

This is where the "Make in India" initiative can help making the CPEC economically less attractive. If we improve our rail/road/port infrastructure, bring land/tax reforms, resolve power supply issues and remove bureaucratic hurdles to make the environment more investment/business friendly, we can successfully move manufacturing from China to India. In the 2016 Global Retail Development Index (GRDI) that ranks the top 30 developing countries for retail investment worldwide, India has already secured second place on ease of doing business. In 2015, we were at 14th place. We must continue land, tax and bureaucratic reforms.

It is already becoming difficult for China to control its production costs. When production moved to China in the early 1990s, labour and infrastructure were available at throwaway prices but now the cost of living in China has increased manifold – taking a toll on production costs. Labour is not as cheap there as it used to be in 1992-93.

China has already started feeling the heat. As per the *Global Times* (a Chinese government mouthpiece), "The increasing competition from India raises a tough question for China's manufacturing sector of how to keep its competitive edge at a time when the nation's labour cost advantage is shrinking rapidly. Now it is time for China to map out concrete measures to reduce production costs for manufacturers," the *Global Times*' article said, "Despite India being more attractive to manufacturers than ever, it will be difficult for the country to build a complete industrial chain overnight."

It will definitely take time, but moving manufacturing to India will kill any faint possibility of using the Gwadar-Xinjiang road for export-import.

The last option in this regard is covert or overt military action. This is the best and most important time to take back POK. If we accept the CPEC passing through POK, it will increase the complexity of the already complex Jammu and Kashmir (J&K) equation. China will have its own stake in J&K and using the CPEC as an excuse, it will stand by Pakistan against India. At present, world opinion is more or less with India, and against Pakistan. India's huge market and economic benefits play a major role in this. The only diplomatic mistake we have made so far is moving away from Russia. We should strengthen our historical diplomatic and economic ties with Russia. This will rule out any possible support Pakistan is expecting from Russia.

The recently signed multi-billion defence agreements signed during the Brazil, Russia, India, China and South Africa (BRICS) Summit in Goa are not sufficient. This will lead both countries to a weapons buyer-seller or weapons co-developer kind of business but the strategic partnership is much more than just that. In December 2014, both countries agreed to increase their bilateral trade to US$ 30 billion. But in 2015, annual trade between the two countries was just US$ 7.83 billion, which showed a stark decline of 17.74 percent in comparison with the previous year. This is where we must work to reignite the decades-old strategic partnership.

India has no objection to any regional cooperation or any Chinese-led infrastructure project. There are five more such projects. But the CPEC completes the "String of Pearls" around us. And it would give an unnecessary boost to the adventurous Pakistan Army, which would not think twice before pulling off another Kargil-like stunt. It has been abusing the `nuclear umbrella`, with the Parliament, Mumbai, Pathankot and Uri like attacks. The Chinese stake will give it one more reason to try again.

... Options for India

Notes

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