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China's Belt and Road Initiative: A Perspective from Pakistan

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Synopsis

This paper offers a critical overview of the Belt and Road Initiative (BRI), which is a Chinese development strategy that focuses on economic, cultural and political cooperation between China and the world through the land-based and maritime Silk Road. In particular, it discusses the Pakistani section of the BRI, known as the China Pakistan Economic Corridor (CPEC). The paper discusses the financial and other aspects of CPEC, highlights its significance for China and Pakistan, and also outlines some key issues and challenges.

Key words: Belt and Road Initiative, China Pakistan Economic Corridor, One Belt One Road, Silk Road

Introduction: The Belt and Road Initiative

The Belt and Road Initiative (BRI) is a Chinese development strategy that focuses on connectivity and cooperation between China and the world through the historical land-based and new maritime Silk Road. The initiative was introduced by Chinese President Xi Jinping in 2013 to boost economic and wider social links between China and the global regions including South Asia, Southeast Asia, Middle East, Europe, Oceania and Africa (Swaine, 2015). The initiative is aimed at boosting the common prosperity of more than 65 countries along the Belt and Road.

This paper offers an overview of the BRI with a specific focus on financial and operational aspects of its Pakistani section, known as the China Pakistan Economic Corridor (CPEC). Given the enormous scale of investment and infrastructure development related to this initiative (estimated to be more than \$60 billion for CPEC alone) (Siddiqui, 2017a), it is important to pay attention to the vast need of technically and cross-culturally competent managers and leaders for CPEC/BRI projects. Given the newness and paucity of research and information on this topic, the paper reviews multiple sources including government documents, consultant reports and media articles related to BRI and CPEC.

China is one of the largest global economies with a GDP of over \$11.2 trillion (World Bank, 2017). The country is projected to become the world's largest economy in 2050, with a GDP of \$58.5 trillion, up from \$5.7 trillion in 2010 (PwC, 2017a). The construction of Belt and Road may be seen as the Chinese response to the new era of economic globalization, in expanding its economic, cultural and political outreach as well as meeting the demands of countries along the historical Silk Road. Chinese officials often emphasize connectivity, inclusiveness and the interest of participating countries in referring to the BRI (Lingliang, 2016). The initiative provides an opportunity for cooperation and complementation in addition to other regional cooperation mechanisms. However, these countries differ in their ability to pursue transformative development, due to divergence in their economic, socio-cultural and political landscapes.

Also known as One Belt and One Road (OBOR), the initiative is geographically structured along seven economic corridors (PwC, 2017b):

1. China–Pakistan Economic Corridor (CPEC), from Western China to the Indian Ocean through Pakistan
2. Eurasian Land Bridge, from Western China to Western Russia
3. China–Mongolia–Russia Corridor, from Northern China to Eastern Russia
4. China–Central Asia–West Asia Corridor, from Western China to Turkey
5. China–Indochina Peninsula Corridor, from Southern China to Singapore
6. Bangladesh–China-India-Myanmar (BCIM) Corridor, from Southern China to Myanmar
7. Maritime Silk Road, from the Chinese Coast through Singapore to the Mediterranean

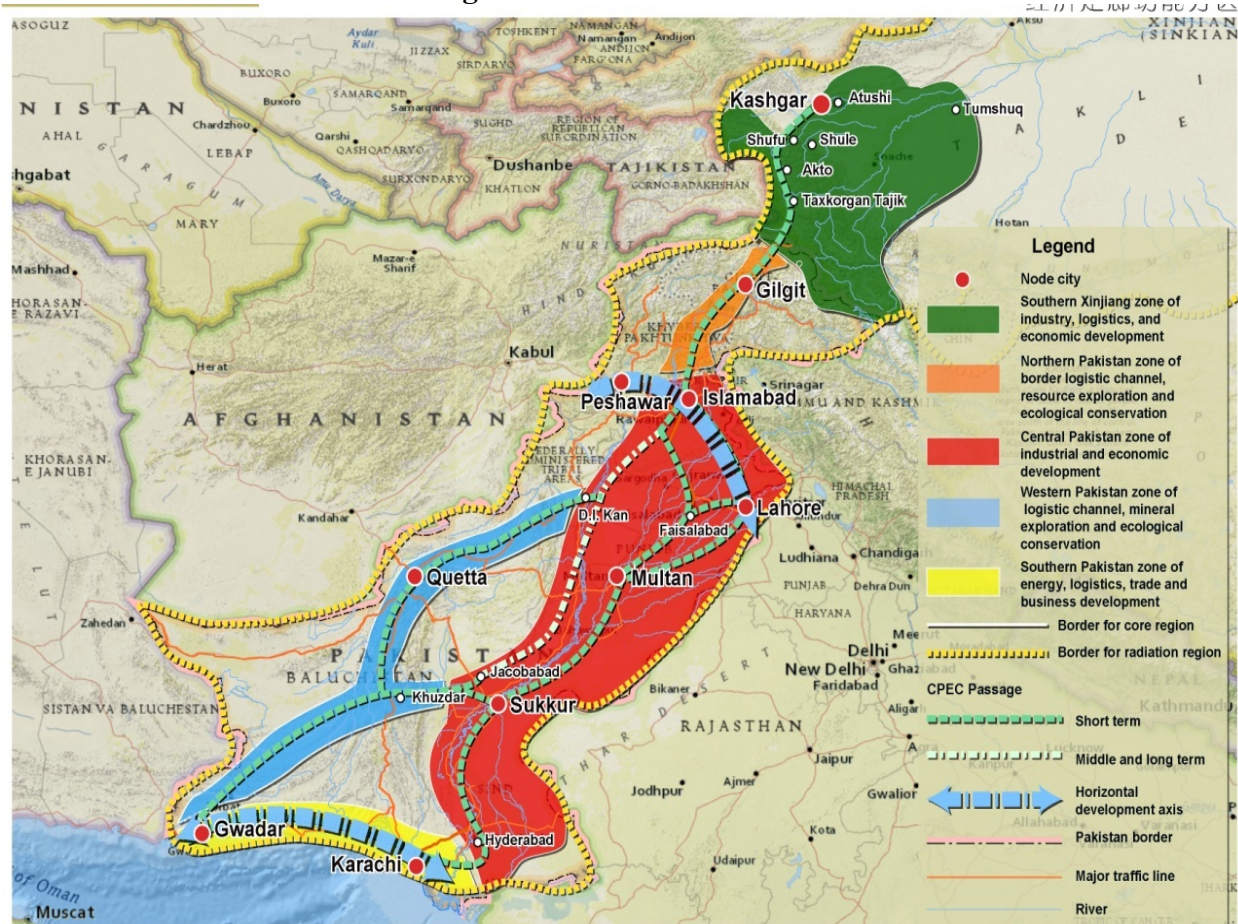
The initiative focuses on connectivity and integration of these regions to develop a cohesive economic area through building infrastructure, broadening trade and increasing cultural exchanges. Next, the paper discusses the main aspects of CPEC, highlights its significance for China and Pakistan, and also outlines some key issues and challenges.

China Pakistan Economic Corridor

CPEC, in the main, comprises infrastructure projects which are under construction throughout Pakistan connecting Western China to the Indian Ocean (**Figure 1**, Kiani, 2018). It

shows three main alignments or routes (discussed next) which constitute the economic corridor around which special economic zones are being planned. Seen as the main plank of the BRI, the value of CPEC projects is estimated to be more than \$60 billion. In November 2016, CPEC became partly operational when Chinese cargo of 250 containers was transported from Xinjiang to Gwadar Port and from there to the Middle East and Africa (Dawn, 2016a).

Figure 1: CPEC in Pakistan



CPEC is focused on modernizing the road infrastructure, energy production, and special economic zones (SEZs). Pakistan government has been establishing SEZs to support business-friendly policies and attract investment across a range of industry sectors. At the Federal level, nine SEZs are being planned across the country (Table 1, SEZ, 2017). An SEZ is an area dedicated to promoting industrial growth through lenient economic and tax policies. Incentives in Pakistan may include the following: lower corporate income tax, tax reductions or exemptions, land-rent reduction and import-duty exemption for eligible projects.

Table 1. Federal SEZs in Pakistan

<i>Province</i>	<i>Location of SEZ</i>
KP	Rashakai Economic Zone
Sindh	Dhabeji
Balochistan	Bostan Industrial Zone
Punjab	M-2 Sheikhpura
Gilgit Baltistan	Moqpondass
Federal Area	ICT Model Industrial Zone & PSM-Port Qasim
FATA	Mohmand Marble City
Azad Jammu & Kashmir	Bhimbar Industrial Zone

The Planning Commission of Pakistan is in the process of setting up 27 SEZs under CPEC by introducing Gwadar SEZ as a first model spreading over 3000 acres. These SEZs will include eight SEZs in Khyber Pakhtunkhwa, seven in Punjab and Balochistan each, three in Sindh and one each in Gilgit-Baltistan and Islamabad. The 250-acre SEZ for Gilgit-Baltistan would be located at Moqpondass for mining and food processing. The largest of all of these SEZs will be based in the Punjab's Pind Dadan Khan Industrial City which would be spread over 10,000 acres and would have industrial units for agriculture, textile, food processing, livestock, manufacturing, and energy (Dawn, 2016b).

Further industrial estates being built in Multan (Phase-II), Bahawalpur, Mianwali, Rahim Yar Khan, Dera Ghazi Khan, and Rawalpindi to support CPEC projects are expected to create thousands of jobs. Another three SEZs were announced in 2016 which include Quaid-e-Azam Apparel Park at M2 near Sheikhpura Interchange, Industrial City located on M3 near Sahiwal interchange, and a 225 acres Value Addition City near Faisalabad on Expressway (The News, 2016).

The newly built and revamped roads will connect seaports of Gwadar and Karachi in southern Pakistan with cities in central and northern Pakistan, and further north with western China and Central Asia. A 1,100 kilometers long motorway will be built between Karachi and Lahore, as part of CPEC. Moreover, the Karakoram Highway (N-35) between Rawalpindi and China's Xinjiang province will be reconstructed and expanded. The railway network in Pakistan will be upgraded, including the Karachi-Peshawar section, and extended to China's Xinjiang Railway in Kashgar. The estimated \$11 billion needed to modernize the road networks will be financed by low-interest loans (Deloitte, n.d.).

Over \$33 billion worth of energy infrastructure will be constructed by private consortia to address severe energy shortages in Pakistan. These shortages regularly amount to over 4,500MW (touching 7,000MW in peak season (Kiani, 2017a)), and are estimated to slash 2-2.5% of Pakistan's annual GDP. Based on higher estimate of energy shortfall, Pakistan economy lost PKR1,439bn (7% of GDP) in 2015 (Pakistan Observer, 2017). As a part of CPEC's fast-tracked "Early Harvest" projects (Deloitte, n.d.) over 10,400MW of energy generating capacity is expected to be produced by the end of 2018. In total, CPEC-related energy projects will eventually produce 16,400 megawatts of power. Moreover, a network of pipelines will transport liquefied natural gas and oil, including a \$2.5 billion pipeline between Gwadar and Nawabshah, which will further extend westward to import gas from Iran. While fossil fuels will be the main source of electricity production through these projects, hydroelectric, wind-power and solar projects are also being built and installed as a part of CPEC.

Work is also being done to reinforce and expand the communication infrastructure along the Belt and Road. Recently, in May 2016, construction began on an 820 kilometers long Pakistan-China Fiber Optic Project costing \$44 million to improve telecommunication in the Gilgit-Baltistan region, while providing Pakistan with a fifth route for telecommunication traffic (*Economic Times*, 2016).

CPEC has been divided into three phases: short-term plan to be completed by 2020, mid-term plan to be completed by 2025 and long-term plan to be completed by 2030. The long-term plan has seven pillars, and it identifies the broader areas for cooperation between China and Pakistan.

Three alignments or routes

Pakistan's National Highway Authority (NHA) has been authorized to plan and develop CPEC connecting Khunjerab in the north to Gwadar in the south along three routes or alignments, namely, Western, Eastern and Central.

Western Alignment of the CPEC has a total length of 2,463 km, starting from Khunjerab and passing through Burhan (Hakla), DI Khan (Yarik), Zhob, Quetta, Surab and Hoshab terminates at Gwadar. Its 615 Khunjerab- Raikot section has been completed, Raikot Thakot is at planning stage, 188 km Thakot-Havelian section is ongoing, 60 km Havelian- Burhan section is ongoing, 285 km Burhan (Hakla)-Yarik (D.I.Khan) is ongoing, 235 km Yarik (DI Khan)-Zhob is under procurement stage, and 331 km Zhob-Quetta is at planning stage. Moreover, 211 km Quetta-Surab existing alignment has been rehabilitated while 449 km Surab-Hoshab section and 193 km Hoshab-Gwadar section have been completed.

Eastern Alignment of the CPEC has a total distance of 2,686 km, starts from Khunjerab and passes through Thakot, Mansehra, Burhan, Pindi Bhatian, Faisalabad, Multan, Sukkur, Shikarpur, Ratto Dero, Khuzdar, Basima and Hoshab and terminates at Gwadar. About 793 km section of Eastern Alignment from Khunjerab- Burhan is common with Western and Central alignments. Further sections of the Eastern alignment have a total length of 1908 km including: 293 km Burhan-Pindi Bhattian section at planning stage, 53 km Pindi Bhattian-Faisalabad section is planned, out of 240 km Faisalabad-Multan section 58 km Faisalabad-Gojra portion has been completed while work on 126 km Gojra-Khanewal section is ongoing, and 56 km Khanewal-Multan section has been completed. Work on 392 km Multan-Sukkur section is ongoing, 37 km Sukkur- Shikarpur section has been completed, feasibility study of 49 km Shikarpur-Rato Dero has been completed. 180 km Rato Dero-Khuzdar is being completed. Plan of 110km Khuzdar-Basima section has been approved while 361 km Basima-Hoshab and 193 km Hoshab-Gwadar have been completed (TOI, 2017).

Central Alignment of the project which has 1633 km length begins from Burhan (Hakla), passes through PindiGheb, Kot Addu, DG Khan, Rajanpur, Wangu Hills, Khuzdar, Basima and Hoshab and terminates at Gwadar. 115 km Burhan (Hakla)-PindiGheb, 355 km PindiGheb- Kot Addu, 55 km Kot Addu-DG Khan, 49 km DG Khan- Rajanpur, 336 km Rajanpur-Wangu hills are at the planning stage. 113 km Wangu Hills- Khuzdar and 110 km Khuzdar- Basima sections are being constructed.

There is heated political debate amongst various provinces of Pakistan with Khyber Pakhtunkhwa and Balochistan provinces emphasizing the Western alignment while Punjab naturally interested in the Eastern alignment. However, the most economical and short route, i.e., Central alignment seems to be given least priority currently.

CPEC's Seven Pillars

The seven pillars of CPEC's long-term plan are connectivity, energy, industries and industrial parks, agricultural development and poverty alleviation, tourism, cooperation in the areas concerning people's livelihood, and financial cooperation (Yousafzai, 2017).

The **connectivity** pillar includes the construction of an integrated transport system and information network infrastructure. It includes the construction and development of road and railway infrastructure from Kashgar to Gwadar through three alignments or routes. Capacity expansion and modernization of existing railway lines are part of the integrated transport plan. The project also focuses on the construction of new international airport at Gwadar.

In information network infrastructure, China and Pakistan will boost information connectivity and cooperate through construction and operation of local communication and broadcast networks.

In the **energy-related fields**, China and Pakistan are working together in the sectors of electricity, power grids and oil and gas. A major focus of CPEC is on establishing new power plants (thermal, wind, hydro, solar and hybrid) to address current power shortages in Pakistan. There is also cooperation in the development of oil and gas resources and pipeline projects. Oil refineries and storages at Gwadar and along the CPEC route are a part of the wider plan.

In the area of **industry development**, China will help Pakistan to promote quality and efficiency of the textile and clothing industry and develop high value-added products. China is also developing the Kashgar Economic and Technological Development Zone and Caohu Industrial Park to facilitate regional trade. In Pakistan, there will be a focus on promoting industrial capacity in sectors such as chemicals, engineering, iron and steel, and construction materials.

In **agricultural development and poverty alleviation**, there is a focus on the development of agricultural infrastructure, training of agricultural personnel, and technical exchanges. There will be a focus on areas such as biological breeding, production, processing, storage and transportation, disease prevention and control, water resources development, land development and remediation, ICT-enabled agriculture and marketing of agricultural products for the systematic and large-scale development of the agricultural industry. These measures will enable a transition from traditional agriculture to modern agriculture in the regions along CPEC to boost the local agricultural economy and eradicate poverty.

As regards **tourism**, tourism resources and opportunities in the regions along CPEC, especially the China-Pakistan border areas, will be developed. There will also be a focus on coastal tourism (from Kaiti Bandar to Jewani), northern Pakistan tourism in Gilgit Baltistan, and cross-border tourism. In 2015-16, there was a 25% growth in tourism to Gilgit Baltistan, the northern areas of Pakistan, bordering China. Around one million people visited that area in 2016, a number not witnessed before (*The Express Tribune*, 2016). Accordingly, the hospitality industry too is likely to flourish.

As regards **people's livelihood** and non-governmental exchanges, CPEC will focus on comprehensive service capability of the cities along CPEC. For this purpose, experiences of urbanization from China and other countries will be used for the municipal construction of the node cities along CPEC such as to upgrade the public transport system and water supply and drainage systems.

In **financial cooperation**, the two countries have established multi-level cooperation mechanisms and policy coordination. There will be a focus on financial reforms, innovation in financial products and services, and reduction in risks to create a conducive financial environment. There is an increased cooperation between the central banks and financial regulatory agencies of

the two countries and a settlement platform for RMB cross-border trade. Moreover, the two countries will promote the opening and development of the securities markets and the multi-currency direct financing of Pakistan's central and local governments, enterprises and financial institutions in China. The two countries will strengthen cooperation between the stock exchanges and support enterprises and financial institutions in carrying out direct financing for projects along CPEC in each other's capital markets.

CPEC's Significance

Significance for China

CPEC's significance for China is reflected by its inclusion in China's 13th five-year development plan (PwC, 2017b). CPEC projects are expected to provide several benefits to China: (a) a shorter and cheaper route by which China can conduct trade with South and West Asia, Middle East, Africa and Europe, (b) development of Western China to bring it at par with developed regions in Eastern and Southern parts of China, (c) utilization of surplus capacity including human resources and technology from Chinese public and private sector companies - owing to massive stimulus, the construction and engineering sectors in China boomed since 2008, there is a surplus capacity of steel, cement, chemicals etc which China intends to consume, and (d) development of stronger economic, cultural and political linkages with countries across the world. For example, the actual sea route from Beijing to the Persian Gulf is about 12,900 kilometers long. In contrast, Gwadar Port in Pakistan is only 2,000 kilometers from China's Kashgar city while Kashgar is around 4,400 kilometers from Beijing (Ebrahim, 2015, Google, 2018).

From a macro BRI perspective, trade between China and Belt & Road countries has exceeded \$916 billion in 2016, which is 25.9% of China's total foreign trade volume. Chinese companies have since established over 70 overseas economic and trade cooperation zones. Moreover, China has also been able to expand circulation of the Renminbi (RMB) and internationalization of its currencies. It has conducted RMB bilateral swap agreements with nations that stretch new Silk Routes (PwC, 2017b).

The BRI will also enable China to utilize its surplus industrial output. According to an estimate, 580mn tons of cement is needed yearly for infrastructure projects in Asia alone, which is a quarter of China's output. Similarly, construction of railways, pipelines, and other projects along the B&R trade route may create demand for 272mn tons of steel.

According to official figures, China's direct investment into B&R countries totaled \$14.5bn in 2016; total overseas newly signed contracted projects in B&R countries reached \$126bn, making up about half (51.6%) of China's total overseas contracted project value in 2016 (PwC, 2017b).

In 2017, Forbes noted that CPEC would shape the next era of globalization and greatly boost Chinese exports and international business (Mourdoukoutas, 2017). According to Hua Chunying, Chinese Foreign Ministry Spokesperson, the corridor will "serve as a driver for connectivity between South Asia and East Asia." The Corridor is expected to play a crucial role in the regional integration of the 'Greater South Asia', including China, Iran, Afghanistan, and stretching all the way to Myanmar (Tiezzi, 2014).

Significance for Pakistan

The benefits that Pakistan is likely to gain from CPEC include the upgradation of the road and deep-water port infrastructure, an enhanced capacity for energy production, and a boost in

manufacturing activity due to the SEZs. Moreover, there are opportunities for technology transfer in the manufacturing sector of Pakistan through foreign direct investment or through collaborative arrangement. Also, the initiative provides an opportunity to position Pakistan as a major transit point connecting the Eurasian region with South Asia and South-East Asia, which is much needed for the country's economic growth (Javaid & Javaid, 2016). In 2017, Pakistan Credit Rating Agency (PACRA) suggested that the establishment of energy projects under CPEC would help overcome shortage and play a positive role in achieving the required economic growth of 7% in the next two to three years (Siddiqui, 2017a).

CPEC is the largest financial investment in Pakistan since the country's independence in 1947. In April 2016, Zhang Baozhong, chairman of China Overseas Ports Holding Company (COPH) illustrated that his company planned to spend an additional \$4.5 billion on roads, power, hotels and other infrastructure (Johnson, 2016), which would be one of the largest ever foreign direct investments into Pakistan.

Currently, Pakistan is facing energy shortfalls on a regular basis. These shortages are a major interference to production and foreign investment. For example, Pakistan's textile industry has been adversely affected by the long power cuts, with almost 20% of textile factories in the city of Faisalabad shut down due to lack of electricity. CPEC's "Early Harvest" projects are expected to resolve shortages in power generation by 2018, increasing Pakistan's power generation capacity by over 10,000 megawatts. With an improvement in energy supplies, the Pakistani government expects economic growth rates to improve.

Furthermore, once fully built, the Corridor is expected to generate significant revenue from transit fees levied on Chinese and other foreign goods—to the tune of several billion dollars per annum. According to an estimate, CPEC-related transportation would earn \$400–500 million per annum for Pakistan and may improve Pakistani exports by 4.5% annually till the fiscal year 2025.

CPEC is expected to renovate Pakistan's economy by modernizing its road, rail, air, and energy transportation systems, and connect Pakistani ports of Gwadar and Karachi with China's Xinjiang province (Ahmed, 2017). This would help reduce the cost and time of transporting goods and services between the two countries (Sawas & Anwar, 2017) and beyond. Consequently, Pakistan's GDP is expected to grow more than 5% by 2020. PricewaterhouseCoopers predicts that Pakistan's GDP may reach \$4.2 trillion by 2050 (PwC, 2017). Currently the country's GDP is about \$ 318 billion (2017 est.). Part of the future projected growth may be attributed to CPEC.

According to a study by the Asian Development Bank (ADB), "CPEC will connect economic agents along a defined geography. It will provide connections between economic nodes or hubs, centered on urban landscapes, in which large amounts of economic resources and actors are concentrated. They link the supply and demand sides of markets" (Brunner, 2013). The initiative is likely to enhance private investment because of a positive environment, economic opportunities and improved infrastructure which may lead to stabilizing the economy of Pakistan (Irshad *et al.*, 2016). For example, in November 2016, Hyatt Hotels Corporation announced its intention to open four properties in Pakistan, in partnership with Bahria Town Group, citing CPEC as one of the key reasons behind the \$600 million investment.

Thousands of jobs are being generated and thousands more are expected to be generated through CPEC related projects. While up to 10,000 Chinese workers are currently working in Pakistan on work visa, tens of thousands of Pakistanis too are employed on these projects. It may be noted that labor costs in Pakistan are very competitive, four to five times lower than China (BR, 2016). Thus, labor-intensive firms will naturally look at Pakistani workforce in order to be competitive and cost-effective.

According to an estimate by the International Labor Organization (ILO), CPEC will create around 400,000 jobs (APP, 2017). The Applied Economics Research Centre (AERC) estimates that CPEC could create over 700,000 direct jobs between 2015 and 2030. This may increase annual economic growth by 2.5% (APP, 2016). Yousafzai (2017) suggests that by June 2017, CPEC had created 30,000 jobs for Pakistani workers and engineers (including 16,000 working in the energy sector). A further 8,000 jobs were being carried out by Chinese nationals. Work on transport infrastructure had created around 13,000 jobs by June 2017 (PCN, 2017).

Employment and development opportunities associated with CPEC projects are also expected to help social and political issues. According to China's Prime Minister, Li Keqiang, Pakistan's development through the project might "wean the populace from fundamentalism."

Financial Aspects of CPEC

While much of the financing for CPEC is being provided by the Chinese government and state-owned banks, there is also significant investment by private consortia. Moody's Investors Service has described CPEC projects as "credit positive" for Pakistan. In June 2017, Morgan Stanley Capital International upgraded the status of Pakistan Stock Exchange (PSX) from 'frontier market' to 'emerging market' status (MSCI, 2017). This section provides an overview of different types of loans and other forms of financial assistance being provided to build various CPEC projects.

Concessionary Loans

Approximately \$11 billion worth of infrastructure projects being developed by the Pakistani government will be financed by concessionary loans, with composite interest rates of 1.6%. Concessionary loans will be dispersed by the Exim Bank of China, China Development Bank, and the Industrial and Commercial Bank of China. Previously, loans for Pakistani infrastructure projects financed by the World Bank carried a much higher interest rate of 5% to 8.5%, while interest rates on market loans were as high as 12%.

The Karachi–Lahore Motorway (costing more than \$6.6 billion) is currently under expansion and construction. For its \$2.9 billion section that will connect Multan with Sukkur over a distance of 392 kilometers, 90% of the costs will be financed by the Chinese government at concessionary interest rates (2%), while the Pakistani government will finance the remaining 10%.

The China Development Bank will finance \$920 million towards the reconstruction cost of 487 kilometers of the Karakoram Highway between Burhan and Raikot. An additional \$1.26 billion will be provided at concessionary rates by the China Exim Bank for the construction of the Havelian to Thakot portion of this highway.

There is similar low-interest financing for other projects. Concessionary loans through China's state-owned banks will finance approximately \$7 billion of the planned \$8.2 billion overhaul of the Main Line 1 Railway (Rana, 2016). However, the 27.1 kilometers long, \$1.6 billion Orange Line of the Lahore Metro is regarded as a commercial project and is financed (\$1.3 billion) by the Government of China at an interest rate of 2.4%. The \$44 million Pakistan-China Fiber Optic Project will be completed using concessionary loans at an interest rate of 2%.

Interest-free Loans

China is currently financing several projects in Gwadar costing \$757 million at 0% interest loans. The projects include the construction of a \$140 million East Bay Expressway (connecting Gwadar to the Makran Coastal Highway), the installation of \$130 million breakwaters, a \$360

million coal power plant, a \$27 million project to dredge berths in Gwadar harbor and a \$100 million 300-bed hospital.

In September 2015, the Chinese government announced that it would provide a \$230 million grant to build an international airport in Gwadar, which Pakistan's government will not be required to repay.

Private Consortia

Joint Chinese-Pakistani firms will construct energy projects worth \$15.5 billion. The Exim Bank of China will provide investments at 5-6% interest rates, while the Pakistani government will be contractually obliged to purchase electricity from those firms at pre-negotiated rates. For example, the construction of 1,223MW Balloki Power Plant will be initiated by a consortium of Harbin Electric of China and Habib Rafiq Limited of Pakistan (Kiani, 2015). Chinese state-owned banks will offer loans to the consortium, subsidized by the Chinese government, at an interest rate of 5% while the Pakistani government will buy electricity at 7.973 cents per unit.

In December 2016, a consortium of mostly Chinese companies bought a 40% stake in the Pakistan Stock Exchange (PSX). The consortium comprises Chinese Financial Futures Exchange Company Limited, Shanghai Stock Exchange, Shenzhen Stock Exchange, Pak-China Investment Company and Habib Bank Limited (Siddiqui, 2017b).

ADB and Other Assistance

The E-35 expressway, a 180 kilometers long road linking Islamabad-Peshawar Motorway (M1) in the Punjab province with the Hazara division in Khyber Pakhtunkhwa province, will be financed by the Asian Development Bank (ADB).

The N70 National Highway upgrade project, which will connect CPEC's Western Alignment in the Balochistan province to the Karachi-Lahore Motorway at Multan, will be financed as part of a \$195 million package by the ADB. The ADB will also finance the upgrade of the 531 kilometers long N50 National Highway connecting Dera Ismail Khan in Khyber Pakhtunkhwa province with the Western Alignment in Balochistan. In January 2016, the UK's Department for International Development announced a \$72.4 million grant to Pakistan for improving the road infrastructure in Balochistan, thereby reducing the total ADB loan from \$195 million to \$122.6 million.

The Faisalabad-Multan Road (M-4 Motorway) will be partially financed (\$100 million) by the Asian Infrastructure Investment Bank (AIIB), and co-financed with the ADB for \$275 million. AIIB has also provided a \$300 million loan for a hydropower project in Pakistan (Hsu, 2017). Also, the UK government will provide \$90.7 million for the Gojra-Shorkot section of the M4 Motorway project.

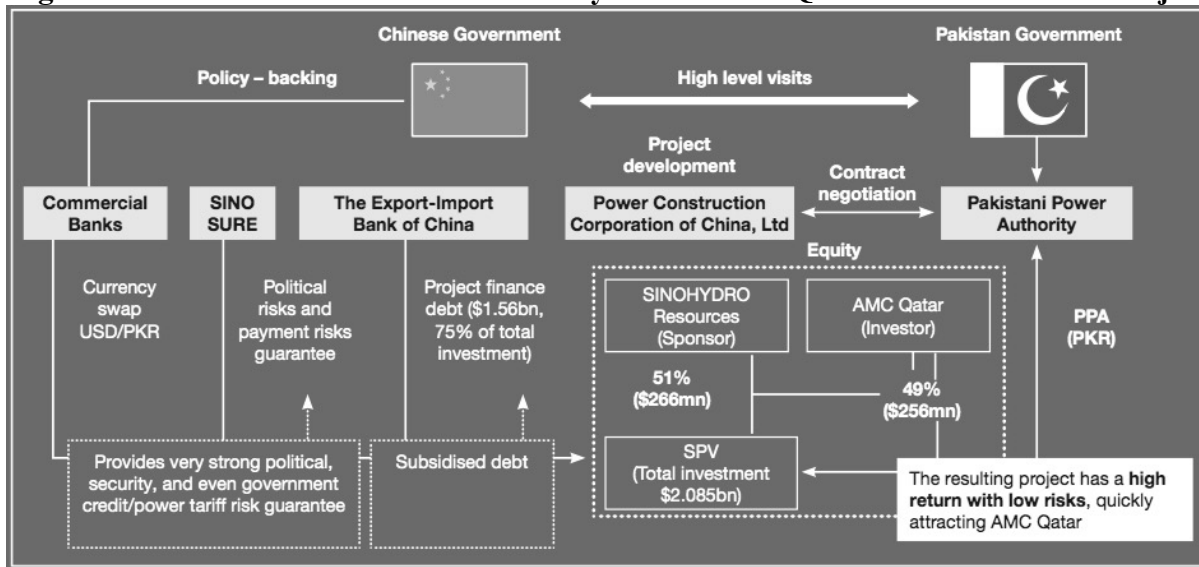
Examples of Success and Challenges

The Belt and Road Initiative including CPEC provides an opportunity to international investors to partner with Chinese companies by providing capital and investments. These projects are usually backed by the Chinese state and therefore there is an improved risk-return ratio in many situations. Furthermore, given that Pakistan and other host governments have received significant financing from China and multilateral banks, these governments will take more care to minimize disruptions. While not all B&R projects may offer sound investments, since some of these projects are deemed strategically important even if they may not be profitable, there are others which may

offer a lucrative opportunity for investment. China and host countries usually welcome investment support to bridge the funding gaps on some infrastructure projects.

For example, Qatar's Al-Mirqab Capital (AMC) partnered with China's state-owned enterprise, Sinohydro Resources, with a 49% share in the construction of a 1320MW thermal power plant in Port Qasim (Karachi) under CPEC owing to the attractive returns. As a result of this partnership, AMC significantly mitigated its risks because of Sinosure's backing to cover a wide scope of risks. As a result, the 'multilateral public-private partnership (PPP)' project built on a Build-Own-Operate (BOO) basis offered attractive returns with significantly mitigated risks, thereby attracting further investments from Qatar's AMC (see Figure 2) (PwC, 2017b). Figure 2 shows the mechanism of policy-backing and insurance by Chinese government as well as high level involvement of Pakistan government which encouraged the investor (AMC) to invest \$256m equity along with Sinohydro Resources.

Figure 2: Multilateral PPP Model of Sinohydro Pakistan Qasim Thermal Power Project



Another similar example is Coal-Fired Power Plant in Sahiwal with a capacity of 1320MW. With an estimated cost of US \$ 1600 Million, the plant was executed and commissioned by Huaneng Shandong Rui Group of China with the coordination of Ministry of Water and Power and supervised by Punjab Power Development Board. The project was completed in 2017 and has been connected to National grid.

Similarly, a Wind Farm in Gharo, Thatta (Sindh) with a capacity of 50MW was commissioned by Hydro China Dawood using Wind Turbine technology. With an estimated cost of US\$ 125 Million, the project was commissioned and executed by M/s Hydrochina Dawood Power Pvt. Limited (HDPPL) with the coordination of Ministry of Water and Power and supervision of Alternative Energy Development Board (AEDB). The project is operational since April 2017.

While the above examples offer a story of success, there are also examples of challenges and gaps. For example, in terms of commercial viability assessment, the following BRI experience in Sri Lanka illustrates that insufficient market demand is contributing to a loss of \$18 million a year at the Mattala Rajapaksa International Airport in Sri Lanka. Mattala Rajapaksa International Airport opened in 2013 at a cost of \$209 million, of which more than 90% came through a loan

from China. The airport was designed to cater to a million passengers a year to ease Sri Lanka's air traffic congestion. However, it is located in Hambantota, a developing city in the south of Sri Lanka, without the commercial activities or large resident population to support the need for an international airport. Furthermore, usage of the airport was restricted by the need to develop the supporting infrastructure ecosystem of highways and commercial real estate, at a time when the government and president were thoroughly reviewing all infrastructure projects that had been approved by the previous government.

In 2014, only 69 tons of freight and 21,000 passengers per year passed through this airport which is very less when compared with 200,000 tons of freight and 8,000,000 passengers per year that passed through Bandaranaike International Airport in Colombo. Consequently, instead of strengthening and reigniting the Sri Lankan economy, the Mattala airport added to a massive debt of over \$8 billion to China and contributed to an IMF bailout. Sri Lankan Airlines subsequently shut down its operations in January 2015, citing that 'Mattala Rajapaksa International is not needed and is a distraction in Sri Lanka's efforts to turn itself around.' In October 2016, China agreed to run the debt-riddled, revenue-draining Mattala Rajapaksa International Airport, in an attempt to turn it around (PwC, 2017b). In the light of the Sri Lankan experience, policy makers and investors in Pakistan may carefully analyze the issues of excess-capacity, business mode and benefits to local people and economy in the context of CPEC projects.

Concerns

Security Concerns

A key issue that Pakistan continues to face is security, especially in certain areas of the Khyber Pakhtunkhwa province and Balochistan province, where Baloch nationalist militants (such as the Balochistan Liberation Army) as well as takfiri (hardcore radical or exclusivist) Islamist militants (such as the Taliban, Lashkar-e-Jhangvi and other militant outfits with overlapping membership, mostly representing an extremist section within the Deobandi offshoot of Sunni Islam) target security forces, government officials, ethnic/religious minority groups, power pylons and gas pipelines causing significant human and economic damage (Shah, 2016; Syed *et al.*, 2016). In some instances, Chinese engineers and workers have become victims of such attacks.

Pakistan faces Taliban insurgent violence which largely began in 2008. The outlawed takfiri militant groups such as the Tehrik-i-Taliban Pakistan (TTP) and Lashkar-e-Jhangvi (LeJ) and more recently the Islamic State (IS) are known for their involvement in attacks on Chinese nationals, and Chinese commentators have raised concerns about the safety of Chinese engineers and construction workers. China reportedly has expressed concern that Uyghur Islamist militants in Xinjiang are in collaboration with the Taliban, Jaish-e-Muhammad and other militants in Pakistan. A related concern is that Chinese workers could become increasingly vulnerable to Taliban militants and Baloch insurgents. In recent years, there have been several attacks and kidnappings of Chinese workers in Pakistan (Arifeen, 2017).

The government of Pakistan is currently making efforts to ensure that security measures are in place in areas where CPEC projects are being built. In 2014, the Pakistan army launched Operation Zarb-e-Azb (and the subsequent Operation Radd-ul-Fasad) to eradicate Taliban and affiliated takfiri militants from Pakistani territory. The Pakistan Army has established a Special Security Division (SSD) to safeguard personnel and properties related to CPEC (Khan, 2016).

Pakistan Navy and Chinese Navy ships will jointly guard the maritime corridor. Since December 2016, the Pakistan Navy has established a special task force "TF-88" to ensure maritime

security for trade. China plans to provide four ships to the Maritime Security Agency for this purpose.

While Pakistan Army will deploy 12,000 troops to safeguard the CPEC route, police officers will also be deployed. As of August 2015, 8,000 Pakistani security officials were deployed for the protection of over 8,100 Chinese workers in Pakistan (Gishkori, 2015). Currently, to protect Chinese and Pakistani individuals and companies that are working on CPEC, a special force comprising 15,000 individuals is deployed. Following the launch of the military operations, violence in Pakistan has significantly declined.

It may be noted that the public will share the burden of this additional security borne by the Pakistani government. In August 2017, the National Electric Power Regulatory Authority (NEPRA), the power sector regulator in Pakistan, allowed power producers to charge (consumers through tariff) one per cent of capital cost of 19 power projects worth \$15.56 billion under CPEC for 20-30 years on account of security cost. NEPRA worked out the annual cost at about \$2.92 million (Rs315 million). In its order, NEPRA referred to Article 10 of the CPEC Agreement which provides that “the Pakistani party shall take the necessary measures to ensure the safety of Chinese personnel and projects” and noted that the country had established a special security force/division of the armed forces to ensure security of CPEC projects (Kiani, 2017b).

Concerns have been voiced by the Chinese about the security, speed of completion and costs of BRI related projects. In August 2013, Lin Dajian, of the Department of International Cooperation in the National Development and Reform Commission, highlighted the security issues and other challenges that could impede the progress of the project (SOP, 2013). In 2016, a nationalist Chinese paper, the Global Times, remarked that the increasing cost of security may be a big problem in efficiently pushing forward the projects (Weijia, 2016).

Chinese media notes that much of the security risks over the BRI are concentrated in CPEC, with Beijing aware of the threats Chinese workers face in Pakistan (*China Daily*, 2016). Chinese requirements for security call for a more complex set of solutions, requiring a set of integrated services in which armed personnel are just one of the many components. For example, there is an associated cost related to security and insurance. Chinese insurance sector is beginning to realise the importance of this business niche. Traditional security, counter terrorism, as well as kidnapping for ransom are going to be important considerations for Chinese businesses operating in Pakistan. Special insurance is a lesser-known niche market, but due to the expansion of Chinese FDI, it may prove to be a thriving sector. Leading Chinese insurance companies such as Ping An and China Taiping are already exploring these opportunities in consultation with British insurance experts (Arduino, 2017).

There is also an issue of criticism and suspicion by India and the USA about CPEC and the increasing cooperation between Pakistan and China. While India alleges Pakistan of cross-border militancy in Kashmir, Pakistan alleges that Indian agencies are responsible for violence in Balochistan and intend to disrupt CPEC. There are also questions about the takfiri and sectarian ideologies and fatwas emanating from the Darul Uloom Deoband, the large madrassa based in India where the Deobandi Islamist movement began.

Political Concerns

Within Pakistan, CPEC faces some political challenges in the context of competing claims and demands by different provinces, with allegations that the federal government is ignoring the Western Alignment (route) through Balochistan and Khyber Pakhtunkhwa. While the Pakistan

government claims impartiality, budgetary allocations suggest that the government is, at least initially, focusing more on the Eastern Alignment (Ramay, 2016). According to Zhaoli (2013), "security concerns are critical which helps to determine the path of this corridor," implying that security concerns, rather than political bias, may be responsible for any route changes within Pakistan. The Chinese government in 2015 issued a statement urging Pakistan's political parties to resolve their differences over the project.

The dominant role of Pakistan Army in CPEC is a subject of political debate within Pakistan (Pantucci & Lain, 2016). Victor Gao, a former Chinese Ministry of Foreign Affairs official, notes that 'on the Pakistan side there is uncertainty about which entity wants to take leadership or ownership of the corridor projects...there is a big debate internally over whether the government should take ownership or the military should take ownership' (Bokhari, 2016).

Moreover, there are also concern about rampant corruption in Pakistan. In particular, the way in which the civilian government handles the CPEC project, especially in light of the accusations of corruption in Pakistan government (led by now-disqualified Prime Minister Nawaz Sharif and his younger brother Shahbaz Sharif, the Chief Minister of Punjab) raises questions about timely and efficient delivery of CPEC projects. This then strengthens public perception and military's ability to intervene in politics, not only regarding internal and external security matters but also regarding social and economic progress in general and the implementation of CPEC in particular (Wolf, 2016). Thus, to carry out the essential tasks related to the economic corridor, the military resorts to their traditional 'help-yourself' attitude. In a similar fashion, it has created a foreign policy independent and separate from the rest of the government. The military's sovereignty is evident in large enterprises like the semi-military Frontier Works Organization (a key contractor for CPEC) or the increasingly independent diplomacy with China and engagement in the CPEC projects (Wolf, 2016).

There are also concerns about the rights and participation of indigenous Baloch people in Gwadar and other parts of Balochistan. In May 2016, Pakistan's Minister of Planning, National Reforms and Development, Ahsan Iqbal, assured the people of Balochistan that Gwadar residents, including fishermen, would be regarded as "main stakeholders" in the city's master plan (Syed, 2016). Moreover, the developer of the Gwadar Port announced that it would assist the fishermen to help boost the region's seafood industry by developing and offering programs to improve the quality of local seafood. To address this issue, government officials and private organizations may focus on greater engagement with local communities and organizations to understand and accommodate local sensitivities and interests so that all people could benefit from CPEC projects. This may also help China and Pakistan in improving their people to people and cultural ties.

Financial Concerns

Some aspects of CPEC's finances seem to be shrouded in secrecy. There are questions about the transparency of the process through which contracts are being awarded to construction, energy and other projects. There also seems to be a lack of independent financial and performance evaluation by a third party. The Private Power and Infrastructure Board has been accused of misdeeds in the approval process for coal power plants and tariffs. Pakistan is contractually obliged to purchase electricity from those plants. There are questions about potential irregularities on the tariff approved for the 300MW coal power plant to be built in Pind Dadan Khan by China Machinery Engineering Corporation (Khan, 2015).

Inconsistency in regulatory regimes in China and Pakistan may affect CPEC projects, and some of these projects may be involved in monopolizing or operate assets of national security

interest (e.g., oil refinery and storage tanks, power plants) which may require close regulations to avoid abuse of power or compromise of national interest. The investor returns may also be closely tied to public subsidies for projects such as public transportation, therefore, posing a direct impact on the firm's ability to make revenue and service the loans (PwC, 2017b).

Much of the development of infrastructure, especially the corridor roads, has been assigned to the Frontier Works Organization (FWO), a military engineering company (Ashraf, 2017). However, some of these contracts are not being awarded through an open and transparent process. The process of selection of eligible firms and grant of contracts may be made more robust and transparent.

There are also concerns about trade imbalance which is dominantly in China's favor. In 2016-17, Pakistani exports to China were only 15% of imports from the same country. Exports to China shrank to \$1.62 billion in 2016-17 from \$2.69bn in 2013-14. Imports from China, in contrast, grew to \$10.53bn in 2016-17 from \$4.73bn in 2012-13, an increase of 123%. In 2012-13, Pakistan's exports to China were 45% of imports from China. According to reports, Chinese products are replacing local goods and becoming a dominant force in the domestic market (Iqbal, 2017). Between 2012 and 2017, Pakistan's trade deficit with China tripled, going from \$4 billion to \$12.7bn (Dawn, 2018). It may be noted that Pakistan's major imports from China include electrical equipment, machinery (including nuclear reactors), iron and steel, organic chemicals and manmade filaments, while major exports to China include cotton, rice, ores and fish.

Chinese exports through the Karakoram Highway have entered the Pakistani domestic market, and are usually cheaper due to the relatively higher cost of production in Pakistan. There are also concerns that CPEC may replace Pakistani exports by China's in external markets.

There are questions about Pakistan's increasing burden of external debt and the country's ability to pay back. In March 2017, a report estimated that Pakistan might end up paying \$90 billion to China over a span of 30 years with annual average repayments of \$3-4 billion per year post fiscal year 2020 (Siddiqui, 2017c). However, a boost in domestic production and exports (due to improved energy, infrastructure and economic corridor) may also add an extra \$8 billion per year to the country's exports which may be sufficient to service debt.

CPEC is a debt-financed infrastructure development project. China's lending plans place greater ownership of the financial risk on the recipient of the investment. The host country's ability to repay could also potentially lead to a network of interdependence guided by the exchange of resources and asset ownership. Some African countries are already approaching China to reschedule, freeze debt repayments or to pay back with resources for previous infrastructure projects (PwC, 2017b).

Conclusion

CPEC is a flagship component of the BRI and has enormous significance for both Pakistan and China. Much of the future development and economic activities in Pakistan depend on successful execution of CPEC and its affiliated projects. For China, CPEC is important because it can be showcased as a success story for all other routes and components of the BRI. Indeed, the utilization of Chinese surplus capacity in engineering, construction, chemicals and other industries and the development of Western part of China is high on Beijing's agenda. CPEC thus provides an opportunity for stepped-up research to examine, design and execute optimal trade and investment policies, socio-economic linkages, and management practices to bolster development in China, Pakistan and other countries along the Belt and Road.

Overall, CPEC offers immense opportunity and responsibility to diverse stakeholders in Pakistan and China, including policy makers, entrepreneurs, government officials, industrialists and academicians. All of these stakeholders will need to work together in order to fully capitalize on the opportunities offered by CPEC, and the BRI in general, and critically address empirical question such as the volume of economic activity likely to be generated, income from toll, impact on infrastructure and energy supply and consumption, impact on local economy including domestic production, import and export, and Pakistan's capacity to pay back. Future scholars may address these questions and myths by collecting, analyzing and presenting empirical evidence.

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