PIDE Research Brief

No. 01:2019

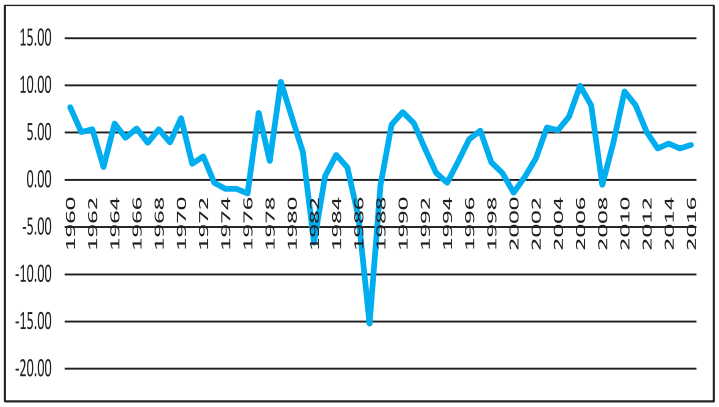
Would CPEC spur Economic Growth?

The China Pakistan Economic Corridor (CPEC) is a multifaceted program ranges from energy generation to development of infrastructure including port, road, railway, and communication. Officials are squarely portraying CPEC as something that will spur economic growth, and will improve living standards. To evaluate official claims it is wise to look into the history of related projects because, "History offers much evidence of the impacts of transformational infrastructure successes and failures", as stated by McCartney (2018). Special Economic Zones (SEZs) and trade facilitation are two important channels through which CPEC is envisioned to spur economic growth, however, it's implementation mechanism is limitedly backing economic considerations? Low national savings, increasing external debt, low tax revenue, and deteriorating exports are the foremost challenges that need to be considered solely relying on CPEC to contribute to economic growth. If these factors are not considered, CPEC initiatives would be similar to those linked to the Panama Canal and Suez Canal, and Greater Mekong Sub-regions that did not contribute to sustainable economic growth despite generated revenue for their respective economies. These projects too had significant geostrategic importance like the CPEC.

Let us quickly review why understanding the above mentioned projects can help us better comprehend the potential presented by the CPEC. Panama Canal connects the Atlantic and the Pacific Oceans, and reduces the ship travel distance between the two oceans. It also helps to avoid 8,000 miles to travel through the Sothern tip of South America. Panama Canal is ranked as one of the seven wonders of the modern world by American Society of Civil Engineers. Initial work on this canal was started off by France in 1881, which could not be completed because of many technical reasons. The United States took over the work and completed this project in 1914. Average time needed to travel through Panama Canal is approximately 12-15 hours which otherwise takes around 25 hours. Since its inception, the annual traffic on this route is exponentially increasing. The annual ships traffic has risen from 1000 in 1914 to 815,000 in 2012. On average around 15,000 vessels use Panama canal each year carrying approximately 225 million long tons of cargo to generate $ 2.4 billion in toll.

The total cost of the project is close to $ 10 billion at today's price. Since 1914 the Panama canal was handed over to Panama in 1999 by the USA. 30 to 40 % of the Panama GDP is linked to the revenue generated from the waterway. If we look (see figure 1) into the GDP per capita growth over time, it does not reflect a sustainable increasing pattern. The physical investment growth model is exhibited in the Panama, and it seems economic policies are not endogenously growth driven. To tackle the competition arising from the Suez Canal is another challenge to be faced by the Panama economy.

Figure 1: Panama Gross Domestic Product (GDP) per capita growth (%)

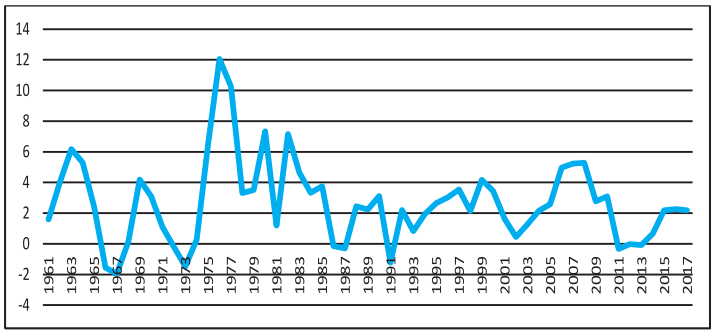


Source: World Development Indicators, World Bank (2018).

On the same pattern as Panama Canal, the Suez Canal connects the Mediterranean Sea to the Red Sea via Suez, Egypt, to reduce 7,000 km of travel distance by avoiding the South Atlantic and Sothern Indian Oceans. The Suez Canal started operations in 1869 officially. The total revenue generated from the tolls was $ 5.4 billion from a total of 21,415 vessels in 2017-18 that carried around 950 million long tons. Along with this landmark project which generates substantial revenue for the Egyptian economy, number of economic reforms were introduced in 1950s, and 1980s including the Land Reforms of 1952, but we cannot see a sustainable increasing growth pattern (see figure 2). Lacking inward-looking policies, and not addressing internal economic factors (budget deficit, low taxation), and relying more on external assistance (Arab countries, and the western world) are the main challenges faced by the Egyptian economy.

[1]Energy is part of trade facilitation measures, but our discussion is mainly on road, port, railway aspects of CPEC. Around 60 % of CPEC chuck goes to energy projects. A lesson can be derive for energy related project to make CPEC a real success.
[2]In term of objectivity we can relate it otherwise it can't be related to CPEC because these are wholly sea p
[3]Road connectivity projected to connect China, Vietnam, Lao, Myanmar, Thailand, and Cambodia. Kicked off in 1992 by Asian Development Bank (ADB).
[4]Mostly developed countries
[5]Namely Board of Investment, Ministry of Planning, Development, and Reform, Provincial Authorities, Departments etc.
[6]Vice President of the United States 1993-2001
[7]Prime Minister of Australia from 2013-2015

Figure 2: Egypt Gross Domestic Product (GDP) per capita growth (%)



In the Greater Mekong Sub-regions the cost of exporting a container of cargo form Cambodia increased from $735 in 2005 to $795 in 2014, in China from $390 t0 $ 823, and in Lao from $1420 to $1950. The reasons for increased cost of doing business are inefficient cross border procedures, lack of a customs transit system, and poor logistic services (Nguyen 2016). Introduction of rail transport does facilitate country's take off by lowering transport cost, and exploring new regional markets by having efficient markets (McCartney 2018). Unfortunately markets are not efficient in Pakistan.

Coming to the CPEC now, we are going to discuss only two components of CPEC (SEZs and Trade Facilitation) to see its current standing to facilitate trade and spur economic growth. So far 7 SEZs are already notified, 9 another SEZ are agreed under the CPEC, and 7 more SEZs are submitted to the Board of Investment (BOI). However, the progress on these SEZs is are limited. After the 18th amendment, industrialization is now a provincial subject, and SEZs authorities are established in each province to facilitate SEZs. Establishment of SEZs is a very coordinated effort of around 23 agencies in Pakistan at federal, and provincial levels. Unfortunately, limited coordination among these agencies is questioning the performance of SEZs. SEZs failure rate is a huge 77% in China. So it is better to first develop just one SEZ after having a detailed feasibility study of that specific location. It should only be replicated across other regions once success is achieved. Unfortunately, the federal government did not develop a consensus to establish a SEZ on a trial basis, conversely, each province were given one SEZ on political grounds. The SEZs has not been driven by economic considerations but primarily by political reasons.

Due to heavy snow Khujerab pass remains closed from November to February. To make it all weather involves extra cost, but this extra cost will negatively affect trade facilitation. Another factor to be considered is that when the traffic from China once it enters to Pakistan will be using the same vehicle to reach its final destination, or will it be unloaded and loaded at the border. In the first scenario, Chinese vehicles drive on the right hand side of the road with left hand driving seat, while it is opposite in the Pakistan. What would be the rule of business (traffic rule) when hundreds of vehicles daily are routing all the way from the North to the South of Pakistan? In the second scenario, it will again increase the cost of doing business to affect trade facilitation negatively.

Panama Canal, Suez Canal and Greater Mekong Sub-regions are the trailblazing projects. These projects demands were originated to benefit regional economics, but before executing these ambitious projects, a detailed feasibility study was not undertaken to study: fiscal consideration of these projects - sharing of revenue with the host economies generated from tariffs, tolls, and custom duties, competition arising from one another, uprising and insurgency movements- Egypt insurgency; and channelization of revenue generated from these project to contribute in economic growth. This lack of insight hindered in the projects not being successful in contributing to the overall economic growth of the countries. In this backdrop, the following recommendations it considered will not strengthen CPEC's viability and as an agent to spur growth.

Recommendations:

Solid scientific study: A solid scientific study is required to understand CPEC dynamics. Unfortunately, limited information is available on the details regarding CPEC. No information has been shared about the total number of vessels and their respective carrying cargo/load that will be landed per day at the Gwadar Port. What would be the total road transport per day? Most of the time officials make statements like, “The resultant benefits of CPEC investments to the Pakistan economy would far outweigh these financial outflows”, “CPEC will generate three times of the total GDP of Pakistan” , “CPEC is an engine of economic growth”. However, these statements are not been backed by any solid scientific study.

Fiscal consideration: Custom duties, tariff structure, and what would be the respective tolls are not available. Loan repayment dates (starting from 2021 to 2025) are known, but their respective modalities are not obvious. It would be much better if phase-wise estimate of the total revenue generated by CPEC may be estimated, so that we can relate it to the GDP. To examine the question of how to maintain fiscal balance is essential. Examining the question of fiscal balance will answer the rhetorics, linked to “Repayment of Chinese loan”, “indebted to China”, “increasing trends in external debt”.

Politicization of CPEC: Unfortunately, politicians and different segments of the society have politicized CPEC for their own point scoring. The politicization of CPEC is not different from Al Gore's politicized climate change, and Tony Abbot's politicized carbon tax. Before Al Gore there was a very positive political engagement from both the political parties in the USA. Now climate change issue has political boundaries, and, the current U.S. is not considering it on a bipartisan plank. The political engagement has severely damaged environment and climate issues. If politicization of CPEC is not stopped, it will further damage this very ambitious project.

Competition arising from Chabahar Port: Chabahar port provides Afghanistan an easy access to the sea, reducing its dependence on Pakistani ports. In 2016, Afghanistan's transit trade through Pakistan was around $3.5 billion. This transit trade is expected to reduce greatly after the Chabahar port becomes fully operational, and Pakistan will lose a significant amount of its transit trade. This loss need to be considered.

Provincial grievances: Trickle down the benefits of CPEC to the provincial economy otherwise it may add to the provincial grievances further. The trickle-down effect will provide an opportunity to the provinces to generate their own financial resources for their respective economic development. Share wise distribution to provinces must be defined categorically so that provincial harmony and ownership be strengthened.

Channelization to boost exports: First, possible measures is to develop and expedite coordination among the 23 agencies, and selection of the first SEZ based on sound feasibility study to make SEZs a real success. Second, to repay the debt of around $3.5 to 4.5 billion in 2025 requires exports growth of at least 10 % per year. In this backdrop indigenization of technologies, and cluster-based (SEZs) growth strategies without any discrimination to the industries outside of the SEZs should be considered to materialize CPEC's benefits to boost Pakistani exports. Improved infrastructure - roads, ports, railway, and energy- network by CPEC needs to be channelized to enhance exports competitiveness.

References:

1. McCartney, M (2018), “The china-Pakistan Economic Corridor (CPEC): Considering Contemporary Pakistan Through Old-Fashioned Economics and Historical Case studies”. The Lahore Journal of Economics, 23:2, pp. 19-48
2. Nguyen, C M (2016), 6 challenges to advancing GMS economic corridors
3. Panama Canal Authority www.pancanal.com/eng/
4. suezcanal.gov.eg
5. Zaidi, H. and Mirzoev, T. (2017), 'The Macroeconomics of Pakistan's Quest for Energy and the CPEC', in Pakistan Selected Issues 'IMF Country Report No. 17/213'.

Prepared by:
Dr. Ghulam Samad
Director, Centre for Environmental Economics and Climate Change (CEECC)
Email: samad@pide.org.pk | Tel: 051 9248156

Dr. Muhammad Zeshan
Senior Research Fellow, Centre for Environmental Economics and Climate Change (CEECC)
Email: zeshan@pide.org.pk | Tel: 051 9248159