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QUAID-E-AZAM LECTURES

CPEC, CAREC AND PAKISTAN[1]

Ishrat HUSAIN*

Pakistan has embarked upon an ambitious program of economic cooperation with China under its Belt and Road Initiative (BRI). China-Pakistan Economic Corridor (CPEC) is one of the six economic corridors that would connect China with the rest of the world. In the first phase that began in 2015, energy and infrastructure projects along with the development of Gwadar were focused upon. Almost USD 27 billion worth projects have either been completed or in different stages of completion. CPEC is now entering its next phase in which industrial cooperation, trade and market access, agriculture development and poverty alleviation, and socio economic development would be given high priority. However, it is hardly realized that our regional cooperation efforts are not limited to China only. Pakistan is either a member or currently participating in SAARC, ECO, Shanghai Cooperation Organization (SCO) and CAREC. Some of these organizations have been in existence is one form or the other for several decades. However, a dispassionate analysis would indicate that the desired benefits from these regional cooperation initiatives have not yet translated into meaningful results. It is against this background that we should examine as to how CAREC and CPEC can help Pakistan in meeting its development goals. Let me emphasize that it is only when there is a fit between the goals of these regional organizations and the country's own national strategies that there would be positive net gains. Therefore, a win-win situation or positive-sum game rather than zero-sum game should be the outcome of these efforts.

CAREC is a partnership of 11 countries (Afghanistan, Azerbaijan, China, Georgia, Kazakhstan, Krgyz Republic, Mongolia, Pakistan, Tajikistan, Turkmenistan and Uzbekistan) supported by six multilateral institutions to promote development leading to accelerated growth and poverty reduction. The four priority areas are Transport, Trade Facilitation, Energy and Trade Policy. It may be noted that these four

* Professor Emeritus and Chairman CEIF (IBA), Karachi, and Advisor to the Prime Minister of Pakistan on Institutional Reforms and Austerity.

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priority areas are almost identical to those identified under CPEC. Therefore there is an internal consistency between the two initiatives which can produce synergies for the entire region. ADB plans to provide $ 5billion over the next five years in financial support for these priority areas of CAREC, which can be leveraged. Pakistan has already two ongoing mega projects, i.e. CASA hydropower project exporting power from Krgyz and Tajikistan to Afghanistan and Pakistan and TAPI supplying natural gas from Turkmenistan to Afghanistan, Pakistan and India. The recently completed E 35 highway connecting HasanAbdal with Havelian would open up connections with the Northern areas and then with the Central Asian neighboring countries. Thus CPEC infrastructure projects can be connected with Afghanistan and onwards to Tajikstan and Uzbekistan. The route from these landlocked countries to Gwadar would be the shortest for carrying their goods for international trade if road and rail connections are established, trade facilitation across borders is enabled as offshoot of the CPEC or as part of CAREC projects. Many other advantages of this cooperation can be extracted. For example, given the surplus and shortages of skilled labour force in different CAREC countries a labor market information system can be developed focusing on skill needs, regional job matching and placements, language training and cross border higher education and technical training offerings. Similarly, better transport connectivity can help promote agriculture commodity trade. Support for sanitary and phytosanitary measures, transboundary animal disease control, Basin water management and improved management of rivers can be a stimulant for agriculture in the region.

However, in the immediate future, Pakistan has to rely upon CPEC and Chinese investment. China's FDI flows have now reached one-sixth of the total global flows becoming a significant player and the BRI would further enhance these flows from China. There are both push and pull factors that would determine the destination of these flows.

Empirical evidence shows that large market size, infrastructure, trade openness, faster economic growth, currency value and gross capital formation are some of the main determinants of FDI flows to developing countries.

First, let us examine the pull factors which would facilitate the Chinese to choose Pakistan as one of the possible target countries for investments in Pakistan's industries. CPEC has already relaxed one of the major constraints, i.e. the energy shortages by committing almost $35 billion for generation and transmission projects over the period 2015-2022. The other component of the CPEC, i.e. Road and Rail infrastructure, would achieve the completion of three corridors – the Eastern, Central and Western high ways and motorways from Gwadar to Kashgar and upgradation of Peshawar – Karachi railway system. The more important corridor from socio-economic development viewpoint would be the western route, which would integrate several backward districts of Pakistan in Balochistan and Southern KP with the rest of the national economy. Roads and motorways by themselves would not create economic activity, but It is careful planning of the Special Economic Zones (SEZs) to be set up along these corridors which can bring about industrialization, export expansion, employment opportunities, transfer of technology and skills.

On the financial side, Currency swap arrangements between the two countries will allow traders under CPEC to have transactions in Yuan and the Chinese companies investing in the projects of CPEC can have repatriation of profits in terms of Yuan instead of Dollars. Trade in national currencies will shield both the countries against exchange rate fluctuations caused by third country currency.

Another positive development is the cross border fiber optic cable connectivity that stretches from Xianjang to Islamabad, which will provide secure interconnection and avoid international network links thereby reducing internet costs with overall improved internet performance. Fiber optic cable will not only digitally connect Pakistan with China but also the Central Asian Republics. Trade facilitation, E-Commerce, E-Government and interchange of data electronically would be supported by this connectivity.

In addition to the specific measures outlined above, that would help Chinese investors seriously consider Pakistan as destination the size of Pakistan's market, the growing urban class enjoying rising purchasing power and the large proportion of millenials exhibiting global tastes and preferences also act as an attraction.

However, there are several areas in which we have to do a much better job in competing for the Chinese FDI and more importantly, the relocation of the Chinese labour intensive export industries in our Special Economic Zones.

One of the inhibiting factors is the poor quality of our institutions, lack of coordination between different government agencies and the inordinate delays in obtaining approvals clearances and multiple no-objection certificates in a sequential manner. These delays result in cost overruns and slippages in timelines for the completion of the projects. The Federal and Provincial Boards of investment are, in theory, supposed to assist the investors in resolving their problems, but in actual practice, they do not have either the clout or the resources to do so. Accordingly, the popular perception that Pakistan is a difficult and costly place to do business continues to persist. This perception is fortified by the delays in obtaining visas, work permits and frequent security checks and scrutiny.

Another factor that also unfavorably affects foreign investors is cross border trade facilitation both on the sides of imports as well as exports. Discretionary powers in the hands of petty officials for clearances and approvals, convoluted procedures and onerous documentation raise transaction costs and cause impediments for the business in making timely and reliable delivery of goods to their customers. OECD has estimated that trade transaction cost might amount to 15 percent of the value of traded goods. Thus simplification, harmonization, automation of procedures, use of ICT tools and electronic exchange of information are needed to improve the regulatory environment, customs clearance and enhance port efficiency.

Corporate tax rates in Pakistan are also relatively higher than other emerging countries vying for FDI. These rates act as a disincentive for those trying to base their decisions on the maximization of profit after tax across different jurisdictions. Frequent calls by the tax authorities to deposit advance taxes before profits are, in fact generated also tickoff many multinational companies. An unstable and downward moving exchange rate further lowers the returns in dollar terms. The recent experience of December 2017 to December 2018, whereby rupee depreciated by almost 30 per cent has not been very conducive for attracting foreign investors.

Trade-related investment is another area which has not been fully explored. Chinese companies can relocate those industries which have become non-competitive due to rising labour costs. This is already happening in Viet Nam and Cambodia where several companies have shifted their production platforms. Research has shown that China's FDI has contributed to the economic restructuring of Viet nam in the direction of industrialization and modernization, increased export turn over and improved the current account and international payment balance. Viet Nam exports to China have risen from $ 29 billion in 2012 to $ 50 billion in four years time with a large trade surplus in favour of Viet Nam. In the same period, Chinese FDI jumped seven fold from $ 312 billion to $ 2.2 billion. Processing and Manufacturing accounted for 61 percent of total investment capital from China. Textile and garments and metal processing industries alone amount to 50 percent of total Chinese FDI flows. Learning from this lesson Pakistan can also make best efforts to attract the Chinese investors to Pakistan as it is a win-win situation for both the countries. Chinese firms would have an edge in design, branding and market access while their Pakistani Joint Ventures would fabricate or manufacture the goods at relatively low cost of production. The Pakistani factories, if located in the Special Economic Zones (SEZs) along the Road corridors, would be able to ship the goods through Gwadar Port at a relatively reduced cost. This arrangement would enable Chinese partner companies to maintain links with their traditional customers and boost their profitability while create jobs and increase manufactured exports for Pakistan. Unlike infrastructure projects under CPEC, which are Government to Government transactions, industrial cooperation between the two countries would be solely between private businesses.

To promote trade related investment and facilitate Pakistan to become part of the global value chain of the Chinese manufacturers, the Free Trade Agreement between China and Pakistan should be revised and geared towards trade creation opportunities for Pakistan. Tariff concessions should be aimed at those goods and commodities in which Pakistan has revealed comparative advantage and is also able to take advantage of the value chain in which China assembles final goods. For example, the FTA with ASEAN countries has zero tariff on Textiles, Apparels, Vegetables and Fruits, etc while Pakistan has tariff rates on these products that range up to 10 percent. As a consequence, Pakistan has lost preference on 79 per cent exports to China after ASEAN FTA. Exports from ASEAN to China have almost doubled from $ 10 billion to 19.6 billion in the last seven years, while those from Pakistan to China have remained insignificant. Bringing Pakistan under the same tariff regime as enjoyed by ASEAN would help reduce the current trade imbalance. China would continue to remain a dominant exporter to Pakistan as it enjoys price advantage in Machinery and equipment and raw materials needed by the Pakistani economy.

Pakistan has abundant labour mainly of unskilled and semi-skilled nature but is deficient in skilled and technical labour needed for industrial growth. The total number of jobs in the nine SEZ s is estimated to be 1 million at the peak. Therefore planning and arrangements for training in the relevant skills, trades and vocations have to be put in place immediately. Public sector institutes are either nonfunctional or do not meet the requisite standards. Technical and Vocational Institutes operated by the private sector should be established in the SEZs to align the demand in each zone with the curriculum and courses offered by these institutions. Apprenticeship training and attachment with the various industrial units should form an integral part of the curriculum. Master trainers in various fields can be sent to China for six months to nine months of training so that they can come back equipped with the latest techniques and tools and disseminate these among the students.

To conclude, Successful corridors such as CPEC or CAREC can exploit economies of scale, expand the size of market through better connectivity but the recipient countries themselves have to work on strengthening their institutional capacity, human resource and skill development policy, provide ease in doing business and cut down the costs by simplification and streamlining of the procedures particularly those related to trade facilitation. As CAREC member countries are getting urbanized, the growth effects of agglomeration that accompanies urbanization can be quite strong provided the infrastructure linkage is maintained in top shape and conditions are made propitious for private sector investments. The integrated space within economic corridors relies upon free movements of labour and capital and trade & investment flows. Successful corridors require economic density as well as corridor-wide energy & transport linkages. These economic corridors can indeed boost competitiveness through improved logistics, lowered costs of production and distribution of both goods and services under an enabling environment of transparent and predictable policies, credible institutions, properly aligned incentives and resilient investments.