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China-Pakistan Economic Corridor: Energy and Power Play

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For a country already facing power shortages regularly across the nation, combined with growing demand (2.55%-5%) each year, electricity is certainly one of the main issues which Pakistan's authorities need to address (Mustafa 2016). It is for this reason that the priority of energy projects within the China-Pakistan Economic Corridor (CPEC) especially in the initial stages is ranked quite high. The existing electricity demand-supply gap currently exists at 2,500-3,000MW leading to six to eight hours of load shedding (Mustafa 2016). And hence, the promise made by the Pakistani Minister for Water and Power Khawaja Muhammad Asif of complete elimination of load shedding seems quite unrealistic at the moment (*Business Recorder* 2016a). It becomes even more significant as this is the crucial aspect on which the chance of re-election of the ruling government led by Nawaz Sharif of the Pakistan Muslim League depends upon.

With US$34 billion investment allotted for the power sector out of the total US$46 billion supposedly pledged by the Chinese government, CPEC aims to generate 16,400MW of power and solve the electricity shortage in Pakistan (Houreld 2015). In November 2015, the CPEC Committee pledged to complete 14 energy projects by 2018, but things on the ground suggest otherwise (*Dawn* 2015).

When Secretary Ministry of Water and Power Mohammad Younus Dagha suggested that by 2018 the production capacity would be 30,938MW whereas demand would be 25,961MW and availability stand at 26,590MW, when compared to the 2017 targets of 25,080MW against a demand of 24,262MW and availability of 21,096MW, he overlooked the fact that as of June 2016, over the previous three years, Pakistan had added only 2,665MW additional electricity in the system (*Dawn* 2016c). This was admitted by the Minister himself in June 2016 while he was addressing questions regarding the progress of the projects in the National Assembly (*Radio Pakistan* 2016). According to Pakistan's Water and Power Development Authority (WAPDA) in June 2016, during the scorching summer, the country faced a shortfall of more than 5,000MW of power. There were more than eight hours of power cuts per day throughout the country, with considerably more in the rural areas.

Although it is true that a few of the early harvest projects, such as the Enrgo Thar coal project (Sindh), Hubco coal project (Balochistan) and Sahiwal coal project (Punjab) are on track and will probably meet the 2018 deadline, other projects have been delayed, and subsequently moved from the "early harvest" category to "actively promoted projects" category which remain in the pipeline or targeted for completion only by 2020. There have also been projects which have been shelved altogether such as, for example, the Gadani power plant in Balochistan.

Several CPEC projects have been delayed, and subsequently removed from the "early harvest" category while others have been shelved altogether.

The US$9 billion, which was supposed to generate 6,600MW, was inaugurated by Prime Minister Nawaz Sharif at the beginning of 2016 (*The Express Tribune* 2015). Problems of transportation and the lack of commitment on the part of Chinese investors led to the decision of putting the project on the backburner and finally in its scrapping (Kiani 2016b)

Current situation

The power demand in Pakistan reached 21,200MWlast year while production was only 16,548MW (Mohammad 2016). Currently, the electricity-generation capacity of Pakistan stands at 22,797MW, and with an average demand of 17,000MW, the shortfall lies between 4,000MW and 5,000MW, which is expected to increase in the coming years as the population expands by almost two percent annually (Anam 2016).

Further, although the gap between supply and demand has gone down when compared to last few years where it was 7,500MW to 8,500MW, several structural problems persist, creating huge roadblocks for any forward movement (*The Economist* 2012). For example, even after numerous attempts to control the circular debt problem, as of30 June, end of the financial year 2015-16, receivables rose to an all-time high PkRs.684.06 billion while payables mounted to PkRs.299.06 billion (Mustafa 2016).

Pakistan's government though, has managed to bring down the losses to 17% from 18.6% by paying some of the share themselves and waiving off others, recently (Mustafa 2016a).Payments made by the provinces also helped when it came to reducing the dues and in addition, to improving the cash inflow in the power sector, the government is considering installing prepaid electricity meters as advised by the Islamabad Chamber of Commerce and Industry (*Daily Times* 2016b). Simultaneously, attempts are also being made to increase gas (LNG) imports to 'limit accumulation of new payables and gradually eliminate outstanding stocks of the power sector's circular debt (*The News* 2016).There have been encouraging signs such as a drastic 27% cut in generation costs and the upward trends across the country when it comes to the recovery rate of distribution companies (Kiani 2016b). But despite all these efforts the receivables in the month of August 2016 crossed the mark of PkRs.684 billion, highest they have ever been (Kiani 2016b).

Given the fact that PML-N cleared PkRs.480 billion in 2013 and taking into account the massive fall in international crude oil prices the government should have been able to adjust subsidies, take advantage of the savings on import bills and decrease in production costs (Kiani 2016d). However, these benefits have not been passed on to the masses; in fact, there have been cases of inflated bills and undue surcharges on consumers (Kiani 2016d). This leads to the question of whether if and when the CPEC projects bear fruit; the fall in production costs will make any difference, especially when it seems more likely that no matter what, certain consumers will not pay what they owe.

Not all hope is lost, however, if recent reports are to be believed. Many projects are under construction and on track. The solar park in Bahawalpur (Punjab province), which comprises about five per cent of Pakistan's current installed power capacity, is seen as being successful. With the addition of 300MW to already existing capacity of 100MW by Chinese company ZTE Energy, some claim to be fulfilling the energy needs of around 200,000 Pakistani families (*Business Standard* 2016).

In the north, where most of the projects are hydel-power based, progress is visible with the Kohala project in Pakistan-Occupied Kashmir and the Neelum-Jhelum project running smoothly with high likelihood of meeting the August 2018 deadline (Kiani 2016c). Hydro-power generation has a lot of potential but remains unutilized. And going by the claims made by the Minister-in-Charge of CPEC Ahsan Iqbal, 'about US$18 billion worth of projects are in the implementation phase while the remaining portfolios of US$17 billion projects are at the preparation stage' (Aftab 2016).

It is important for Pakistan to showcase its ability to utilize funds and investments flowing from CPEC and showcase itself as a viable economic hub

One of the key elements at least for Pakistan via CPEC is to showcase its ability to utilize funds and investments flowing from abroad and to put itself on the global map as a viable economic hub where things can get done.

Of course, this is not possible when there is acute shortage of power and the major cities of the country are plunged into darkness regularly. In terms of investments, Pakistan will receive three times the total FDI of the last decade through the CPEC, with the main thrust of the project being in energy and infrastructure (Almeida 2015). This affirms Chinese commitment to Pakistan but by itself is not a guarantee of the success of this project. Apart from security-related concerns, a major impediment is the competence of the

Pakistani establishment and institutions. Mismanagement and corruption combined with well-entrenched patronage systems need to be overcome if this has to work and implemented properly on the ground. This initiative might well aggravate some of these problems. Still, the onus is on Pakistan itself to utilize this chance and gain some economic leverage, which will be beneficial for the domestic situation and for its foreign policy.

Perceptions, at home and abroad are fuelled further by the lack of transparency about the terms and conditions of various projects. The Pakistani government though is trying to amplify the progress of few infrastructure projects (mainly road projects) as a sign of change being around the corner. Despite the many challenges, especially when it comes to energy projects, Pakistani Prime Minister Nawaz Sharif remains optimistic as he boldly asserted that power sectors projects remain on track despite the impediments and hurdles. On 1 September 2016, while inaugurating a number of projects in Gwadar he said, 'Some of the projects are going to be completed by the middle of next year. We will have electricity of about 10,000MW by the end of 2017. We hope to eliminate load shedding by 2018 in the country' (*Dawn* 2016c).

Teething troubles

If one closely examines most of the updates and news about some of these projects individually, one can judge the overall efficiency and the actual progress of this initiative. When the dots are joined, the picture is very clear. For example, some of the big energy projects which were propped as being the solution to the problem are facing serious delays. The Port Qasim Coal project in Sindh, which was estimated to add 1,320MW has been embroiled in a centre versus province standoff due to disputes regarding land acquisition, which are still yet to be, solved (Kiani 2016c). The Suki Kinari hydropower plant's fate took a similar turn as it was announced that it faces another delay; one of the 'priority projects' in Mansehra district of Khyber-Pakhtunkhwa, it is facing land acquisition troubles (*The Express Tribune* 2016a, c).

The Diamer Bhasha dam which the Chinese agreed to build in 2015, is embroiled in a dispute between rival tribes backed by the Khyber Pakhtunkhwa and Gilgit-Baltistan governments

Constructed by China Gezhoube Group, the US$1.8 billion project, which was supposed to add 870MW, has been delayed for a year again. And the dispute between the Khyber-Pakhtunkhwa government and the central government is not helping either. In fact, the delay is likely to continue especially given that Chief Minister of Khyber-Pakhtunkhwa, Pervez Khatak has openly accused the central government of stealing electricity of the provinces (*Daily Times* 2016a).To take another example of a project that is strictly not part of the CPEC, the Diamer Bhasha dam, in Gandlo Nala area in Gilgit-Baltistan, which the Chinese agreed to build in 2015, is embroiled in a dispute between two rival tribes (*The News* 2015).

This stretch of land, which is at the border between Kohistan, in Khyber Pakhtunkhwa province, and Diamer in

Gilgit-Baltistan has witnessed multiple clashes in the recent past between rival tribes which are backed by the Khyber Pakhtunkhwa and Gilgit-Baltistan governments (Mohammad2016b).

Growing Chinese pressure and discontent are making the Pakistani government issue warnings to all the stakeholders to meet deadlines or risk deletion of the project from the CPEC

The project is expected to supply 4,500MW of electricity and will make available 7.89 billion cubic meters of water storage to supplement irrigation during low flow period and is seen as critical to solving Pakistan energy woes. Although the federal cabinet approved on 10 September 2016, the plan for the acquisition of land required for construction and promised compensation to the affected people, there is no guarantee that this will be enough to expedite the process on the ground (Ahmed 2016).

The project, which was scheduled to be completed by 2016, is of paramount importance as it would help with irrigation, mitigate the threat of floods and more importantly extend the life of the Tarbela dam for 35 years (Zaafir 2016). Moreover, the project is now also facing funding problems as the ADB which was the lead financier of the project declined to commit when it came to the massive financial requirements of the project (Kiani 2016a).

Multiple projects are facing the danger of being pushed out from 'early harvest' timeline (first phase) to 'actively promoted' (second phase) and this seems to has woken up people at the helm of affairs in Pakistan. Growing Chinese pressure and discontent are making the Pakistani government issue warnings to all the stakeholders involved in these projects to meet the deadlines or "risk deletion of the project from the CPEC" (Rana 2016b).

The water and power ministry has even changed deadlines and ordered projects like Thar Block-II project, the 1,320MW Engro Thar power plant to be completed by December 2018. Similar warnings have been issued to the Sino-Sindh Power Plant, "to start construction of the project or face demotion from the list of priority schemes to the list of actively promoted CPEC projects or even deletion from the corridor altogether" (Rana 2016b).

Apart from land disputes and slow clearances, another set of hurdles, which every project encounters at some point of time relates to taxes and concessions. Even as the government has brought certain measures in play, such as waiving off bidding conditions for some CPEC projects or backing the projects with sovereign guarantees, the main way to dissuade Chinese investors from pulling out has been the reduction of taxes (Rana 2016c). Issues of tax exemption for import of plant and machinery (Port Qasim project), pending cases of tariff agreements (Salt Range power project in Punjab) and availability of coal for many projects still remain quite challenging (Kiani 2016c).

To make some headway, the Federal Board of Revenue (FBR) and the Chinese authorities met to resolve the tax-related issues of projects under the (CPEC) on 29 June 2016 (Sarfarz 2016). However, instances like the Gwadar Port Authority (GPA) still being unaware if the project (Swad-Gwadar City Water Supply) is to be developed through a grant, an interest-free loan or a commercial loan from China suggest a tale of confusion in the CPEC (Kiani 2016c). Moreover, when it comes to coal projects, there is need for large amounts of water (10 to 150 gallons per ton of coal) for extracting the coal from the ground as the most common method used in the country is the strip-mining method. Hence, water supply is very essential for even the day-to-day operations and any delay or hurdle would hurt the chances of the projects meeting their deadlines.

The government in an attempt to salvage matters – given the coming elections – has been shifting priority projects around. In July 2016, two coal projects in Sindh which were supposed to supply power to Punjab were demoted and now three LNG-based, 3,600MW power plants in Punjab have instead, become new additions to the priority list (Rana 2016d). Apart from citing the viability of the project as the reason for this shift, the Planning and Development Minister Ahsan Iqbal also said that "not having a transmission line" played a big part (Rana 2016d). This South-North transmission line, which was facing delays over "issues of payment of minimum tax on turnover and payment of alternate corporate tax for 10 years and the tariffs", is looking at complete deletion (Kiani 2016c).

The Asian Development Bank's country manager, Werner Liepach, recently remarked that the ADB is "broadly satisfied with the progress" and the efforts of the Pakistani government could end power rationing in the country in the next two years (*The Wire* 2016). Nevertheless, there remain fundamental problems in the overall approach. Just increasing production capacity is not enough especially when the demand is increasing and power distribution remains poor. Ignoring up gradation and numerous failures of transmission lines and power grids will be detrimental to progress made on other fronts. Technical losses and default evasions combined with enormous power theft add to the problems. The line losses and electricity theft stands at 17.9% resulting in the loss of PkRs.29 billion in 2015-16.

Islamabad has tried to soothe the anxieties of the Chinese government and investors by setting up revolving funds backed by sovereign guarantees

According to Tahir Basharat Cheema, former managing director of the Pakistan Electric Power Company, "the system losses stand at 20 percent of total power generated and distributed, out of which some five percent is electricity theft from the system, while another five percent is the result of outdated system. Remaining, 10 percent is technical losses, which in accordance with the total power sector infrastructure size of Pakistan is negligible" (Rizvi 2016) .So adding capacity to the national grid will only get Pakistan so far, especially if it does not also enhance capabilities and efficiency of existing transmission networks.

Suggesting that economic rationale might halt Beijing's generous contributions however, would also be neglecting the underlying strategic aspects of this grand project. If connectivity is something China needs, there have to be sacrifices made from its side in order to help Pakistan get its house in order and Beijing probably knows this all too well. Although the idea of incurring huge losses and slow progress might worry Chinese investors and sow seeds of hesitation for future inflow of capital to Pakistan, the Chinese government seems unlikely to abandon their 'all-weather ally' so easily.

Having said that, if the Pakistani government does not close the gap between what it earns and what it pays, then the future of CPEC will remain rather bleak (Pal 2015). Pakistani traders and the business community represented by the Federation of Pakistan Chambers of Commerce and Industry have raised their voices asking the government to speed up the process so that Pakistan can fully utilize these investments (*Daily Times* 2016c).

The allocation of funds, projects and the prioritization of their completion appear unequal among the provinces

Pakistan's state-owned entities – the main source of the circular debt problem –are run by the country's elites and any attempts to privatize these entities will be met with huge resistance from the political class. But how long things will stay the same way is hard to say, as the Chinese look to other ways to get things done. To be fair, Islamabad has tried to soothe the anxieties and concerns of the Chinese government and investors.

Setting up revolving funds backed by sovereign guarantees, plans to set up numerous industrial parks and mineral economic processing zones are a few methods it has chosen (*Dawn* 2016a). Also, in June this year, a new rule has been made which makes it compulsory for all ministries/governments/departments to submit the anticipated future disbursements for the CPEC projects to be included in the Public Sector Development Programme for next financial year to ensure smooth flow of funds as per the progress of works (Sarfaraz 2016). At the same time Pakistan's government needs to be careful of the long-term effects on the economy and take into consideration risks of repayment obligations and profit repatriation.

Deepening Political Divisions

Economic development according to the Chinese has been the preferred way to achieve peace for them. But this ambitious endeavor of theirs seems to have deepened the divide and inflamed tensions in the politics of Pakistan. One of the main bones of contentions apart from the route of the corridor seems to be regarding the resource-distribution-formula. One of the biggest allegations against the whole project in Pakistan itself is that in terms of allocation of the funds, projects and the prioritization of their completion is unequal amongst the provinces.

Interestingly even when it comes to the energy projects, out of the total power to be generated through CPEC projects, 4,4210MWis to be generated in Sindh, 3,640MWin Punjab, 960MW in Baluchistan, 870MW in Khyber Pakhtunkhwa and 720MWin POK

(*Business Recorder* 2016b).Statistics presented in the Parliament reveal that 53% of the total projects are being assigned to Punjab – out of the total of 330 projects, 176 are in Punjab (Qadeer 2016). This has led to some accusing Islamabad of favouring the province of Punjab due its high population density and with the upcoming elections in mind.

The tussle between the K-P government and the centre is well known but vehement opposition from some regional parties, especially the Baloch ones is also growing. As of now only eight projects have been allocated for Baluchistan, which could be a huge headache in the long run considering the strategic significance of Gwadar projects and the instability in that region.

The central government needs to allay any sense of deprivation among the provincial governments, parties and the people of these federating units. Political division to this extent does not send a good signal and can worry people both at home and abroad. In fact, on 11September, the Vice Minister International Department of the Communist Party of China, Zheng Ziaosong while meeting a delegation of the Pakistan People's Party in Beijing urged Pakistan to resolve these issues. He stressed that for a project like CPEC to maximize its potential there needs to be 'political consensus coupled with unanimity in approach' (Ghauri 2016).

However, Islamabad's actions such as charging protestors under anti- terrorism law is hardly the answer and highly counterproductive. Protests held in the Gilgit area in August 2016 against the CPEC projects and the ensuing police crackdowns, resulted in the arrest of around 500 young men by the Pakistan Army (*ANI* 2016). This tussle reflects the problems in the implementation process, the provinces for example have in return, expressed their dissatisfaction by not giving the authorization yet for the deployment of the special security forces (*The Express Tribune* 2016b).

Reports are doing the rounds that suggest establishment of a separate 'CPEC Development Authority' with Pakistan Army involvement

Increasing security concerns from the Chinese regarding the safety of their workers combined with growing impatience over the speed of implementation is prompting China to explore other options. There are numerous reports doing the rounds that suggest establishment of a separate 'CPEC Development Authority' with Pakistan Army involvement, something the civilian leadership rejects outright or denies (Siddique 2016).

This can create friction in the already tense relationship between the military and civilian establishment in Pakistan. One of the reasons for this development can also be attributed to the emerging belief that the ruling dispensation, Pakistan Muslim League (Nawaz) would not be able to deliver on its promise regarding uninterrupted electricity. The promise of ending power shortages was in fact one of the reasons which led Nawaz Sharif and his party to power but now it could well be one of the reasons for their downfall.

What could be worse for Beijing is a possibility of this civil-military rift becoming a hindrance to security and affecting timelines of the projects. This was demonstrated by the delay in the deployment of the SSD (Special Security Division) due to jurisdictional issues between the government and the army. Due to this the terms of reference (ToRs) for deployment of the special security force has not yet been finalized (Rana 2016a). A year and a half later since the promise was made by the army to raise such a force to protect the Chinese workers, the government remains cautious about wide-ranging ToRs, which could diminish its own authority and influence on the law enforcement agencies on the ground (Sayed 2016).

Conclusion

Nevertheless, the mood in Islamabad remains optimistic. According to Prime Minister Sharif the CPEC project seeks 'to harness Pakistan's geo-political position into geo-economic advantage by connecting the three engines of growth – South Asia, China and Central Asia' (Aftab 2016). And if the claim made by Miftah Ismail, chairman of Pakistan's Board of Investment about CPEC attracting US$150b, estimated by 'working out on the basis of firm commitments with prospective investors' is real, then there is more to look forward to (Aftab 2016). Even countries like Turkey and Iran have expressed their willing to join the initiative and reap the benefits (Aftab 2016). Ahsan Iqbal, in fact welcomed both Iran and Saudi Arabia, saying 'we will welcome both the brotherly Islamic countries if they want to be part of CPEC' (*Dawn* 2016a)

So the opportunity for Pakistan is out there, to change the way it functions and to be seen by the world community in a positive light. However, the delays in CPEC projects might deal a body blow to the business climate in Pakistan and for Chinese plans in the region. Strategic interests and ambitions of Beijing in the region and on the global stage hinge upon the success of these ambitious projects. These grand designs and visions like the OBOR which has many similarities with the 19th century's 'great game' look like masterstrokes on paper but they have yet to yield results which are required very soon, for Islamabad at least, if not also for Beijing. Through Gwadar, CPEC is expected to play a vital role in China's Maritime Silk Road.

Investments in CPEC are more than just Chinese Marshall Plan to resurrect the Pakistan's economy. The CPEC is also an important flagship project of the Belt and Road initiative to an extent because the success of CPEC will send a clear and positive message to the other countries in and around China. It is the supplementary vein whose success or failure might have a spill over effect or change perception of the long drawn effort of turning the OBOR into reality from a vision. And mostly, China would be the biggest benefactor from the emergence of a stable Pakistan, something which will depend heavily on the energy projects that the CPEC has promised.

The success of these energy projects will be the harbinger of transformational change in the region and the result on Pakistan's economy will be phenomenal. Success of the projects will not only meet the growing demand and end the power crisis in the country but also meet the energy needs of the industries and aid the other projects of development along the CPEC routes. Revolutionizing Pakistan's economic profile will yield China a reliable, much stronger and capable partner on the world stage, something Beijing knows will first require, pulling the country out of the darkness.

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