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# **The China-Pakistan Economic Corridor: Trade Security and Regional Implications**

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# China-Pakistan Economic Corridor: Trade Security and Regional Implications

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## ABSTRACT

International trade and related economic activities in Central and South Asia are increasing as developing economies, particularly India and Pakistan, grow. China continues to emerge as a major regional and global power and has embarked upon numerous regional economic and political initiatives. A major development is the China-Pakistan Economic Corridor (CPEC), a host of infrastructure and trade projects worth over 40 billion American dollars. This report analyzes CPEC and its potential regional effects, including the trade security implications of the port and land infrastructure developments. As trade increases in the region and the major CPEC infrastructure projects are completed, there will be numerous implications on trade security and geopolitics within South Asia. CPEC projects uniquely intersect numerous regional situations, including territorial disputes in Kashmir, the Afghanistan/Pakistan border, and Chinese foreign policy ambitions. A nuanced understanding of these effects can influence future policy adjustments in this region.

*The views expressed in this report are those of the author and do not necessarily reflect the position of Sandia National Laboratories or the author's current and past institutions.*



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## NOMENCLATURE

AIIB	Asian Infrastructure Investment Bank
CPEC	China-Pakistan Economic Corridor
Dawn	Pakistan's largest English-language newspaper; part of larger media group
ECC	Economic Coordination Committee; Pakistan
FAC	Fast Attack Craft; ship system
FTZ	Free Trade Zone
GDP	Gross Domestic Product
GNI	Gross National Income
GoP	Government of Pakistan; central
KP	Khyber Pakhtunkhwa; northern Pakistani province
NTC	National Trade Corridor, Pakistani program
NSG	Nuclear Suppliers Group
OBOR	One Belt One Road; Chinese program
PIFFA	Pakistan International Freight Forwarders; industrial group
PKR	Pakistani Rupee; currency
PML-N	Pakistan Muslim League-N; political party
SECDIV	Strategic Export Control Division, Pakistani Government
SIGAR	Special Inspector General for Afghanistan Reconstruction; US Office
SSD	Special Security Division; Pakistani CPEC security force
USD	United States Dollar; currency
USG	United States Government
WeBOC	Pakistani automated customs website/system



## EXECUTIVE SUMMARY

Pakistan's economy continues to grow, and with economic expansion comes both new opportunities for international cooperation and geopolitical implications. Simultaneously, China is seeking to increase its regional influence both economically and politically. China's One Belt One Road (OBOR) strategy seeks to increase Chinese economic and political ties in Asia, the Middle East, and beyond. The China-Pakistan Economic Corridor (CPEC) is one project under the broader OBOR umbrella. The billions of dollars that will be invested in projects related to CPEC in Pakistan pose a litany of opportunities and challenges for numerous nations. This report analyzes the major CPEC projects currently being built and planned throughout Pakistan—the construction of a major port at Gwadar in the southwest and road, transportation, and energy infrastructure throughout the country—and their potential effects on trade security and regional relations.

CPEC developments amount to a combined value of nearly 50 billion USD and are expected to produce a substantial increase in regional trade. Many projects are being constructed by Chinese companies or through Chinese contracts with domestic Pakistani partners through a coordinated investment strategy. Pakistan has developed a security strategy that includes both provincial and federal personnel dedicated to securing the construction and operation of the infrastructure. Because the successful execution of CPEC projects is a Pakistani government priority, a dedicated force has been tasked with securing all aspects of project development.

The Gwadar Port expansion on the southern coast will make the port one of the largest in Pakistan, and numerous transportation and energy infrastructure projects will increase regional trade and development. With this increased trade and activity, a focus on the potential general and trade-specific security risks will help guide policymaking decisions. Goods originating in China will likely flow through Pakistan, with Gwadar and other areas acting as transshipment hubs. Merchandise making its way to China from the Middle East may also flow through upgraded Pakistani infrastructure on its route. The increase in transshipment volume, combined with legal exemptions for certain firms operating at Gwadar, introduces trade security concerns. In addition to the direct trade security-related concerns, CPEC projects intersect other important regional issues. The roadway and railway infrastructure projects must flow through parts of the disputed Kashmir region to reach China, something the Indian government has expressed concerns about. The Afghanistan/Pakistan border region continues to experience issues stemming from fragile bilateral relations and violence from militant activity, and Pakistan is attempting to construct a number of new border gates to regulate cross-border traffic. In the historically conflict-prone Balochistan province, separatist activity threatens the security of CPEC projects. As Pakistan's economy expands and the threat of militant activities and territorial disputes continue, CPEC will be at an important intersection of regional dynamics.



# 1 PAKISTAN'S CURRENT OUTLOOK

## 1.1 Introduction: Chinese Foreign Policy and Pakistan

China has substantially increased its regional economic and political engagements in recent years through a variety of high-level diplomatic initiatives, economic investments, and political partnerships. The Chinese foreign policy stance of engaging in enhanced economic and political cooperation with other nations, referred to as One Belt One Road (OBOR), is an attempt to expand influence and trade to other areas of Asia, the Middle East, and other regions worldwide.<sup>1</sup> The Chinese decision to begin OBOR-related projects is rooted in both economic and political motivations, as the Chinese Communist Party (CCP) seeks to create strong economic bonds with regional states and maintain its relative economic power. The increasingly globalized trading environment has put a new emphasis on engaging previously smaller economic powers. At the same time, these policies including CPEC are seen by some as a way to expand China's sphere of influence, in part to counter the American 'pivot to Asia.'<sup>2</sup> There are a variety of perspectives of Chinese ambitions in the project, including as a response to the Asia Pivot and as a maritime strategy.<sup>3</sup>

OBOR, announced in 2013, has become an integral part of Chinese foreign policy under Chinese President Xi Jinping. The broad OBOR strategy involves connections with over 50 countries and over 1 trillion USD in planned projects.<sup>4</sup> From further developing Afghanistan's rail network to investing in projects with Pakistan, OBOR is a large-scale initiative intended to enhance China's current engagements with nations in the Central Asian region and elsewhere. With funding from both China directly and indirectly through the Asian Infrastructure Investment Bank (AIIB), billions of dollars are available to support this foreign policy agenda. The AIIB is a multilateral loan initiative for various construction projects, supported by numerous countries.<sup>5</sup> AIIB has been seen as an increasingly useful vehicle for regional development projects of various types.

The China-Pakistan Economic Corridor (CPEC) is one of the most notable of these projects, as it connects China and Pakistan through a number of infrastructure projects. The total amount of investment that Pakistan is expected to receive will amount to 20% of its annual GDP.<sup>6</sup> China is dedicating 46 billion USD<sup>7</sup> to CPEC projects alone, money that will build new infrastructure and broadly expand trading opportunities with China's western neighbor. For energy projects alone, China expects to spend 34 billion USD, a majority of the total (Figure 1). Pakistan and China seek

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<sup>1</sup> Starr, CV. "Testimony before the US - China Economic and Security Review Commission. *Congressional Hearing Testimony*. March 31, 2016. [http://www.uscc.gov/sites/default/files/Elizabeth%20Economy%20Testimony\\_033116.pdf](http://www.uscc.gov/sites/default/files/Elizabeth%20Economy%20Testimony_033116.pdf).

<sup>2</sup> Testimony before the US-China Economic and Security Review Commission by Lisa Curtis, Senior Research Fellow, Heritage Foundation. "China's South Asia Strategy." 3/10/2016.

[http://www.uscc.gov/sites/default/files/CURTIS\\_Remarks%20031016.pdf](http://www.uscc.gov/sites/default/files/CURTIS_Remarks%20031016.pdf)

<sup>3</sup> European Parliament. "Briefing: OBOR: China's regional integration initiative." July 2016.

[http://www.europarl.europa.eu/thinktank/en/document.html?reference=EPKS\\_BRI%282016%29586608](http://www.europarl.europa.eu/thinktank/en/document.html?reference=EPKS_BRI%282016%29586608).

<sup>4</sup> Ahmad, Talmiz. "Silk Road to (economic) heaven." 6/18/2016. *Herald-Dawn*. <http://herald.dawn.com/news/1153432>.

<sup>5</sup> US Government Monthly Analysis of US-China Trade Data. *USCC*. 4/4/2014. Page 13.

[http://origin.www.uscc.gov/sites/default/files/Research/November%202014%20Trade%20bulletin\\_0.pdf](http://origin.www.uscc.gov/sites/default/files/Research/November%202014%20Trade%20bulletin_0.pdf).

<sup>6</sup> Ramachandran, Sudha. "China-Pakistan Economic Corridor: Road to Riches?" *The Jamestown Foundation*. 7/31/2015.

<https://jamestown.org/program/china-pakistan-economic-corridor-road-to-riches/>.

<sup>7</sup> Shah, Saeed. "China Readies \$46 Billion for Pakistan Trade Route." *Wall Street Journal*. 4/16/2015.

to augment economic connections with the rest of Central Asia through a plethora of developments, including ports, energy infrastructure, and highway construction.<sup>8</sup>

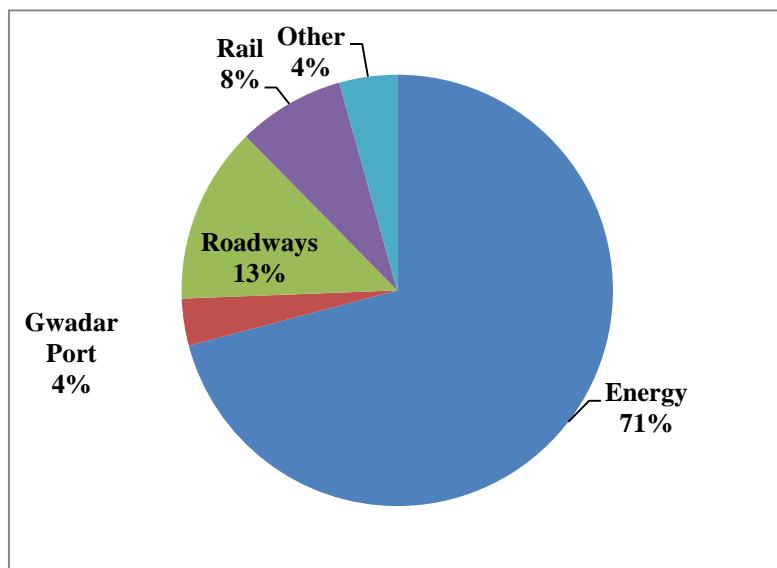


Figure 1. CPEC Funds by Project, Total Approx. 46 Billion.

## 1.2 Pakistan's Economic Outlook

Before analyzing CPEC projects and their primary regional effects, an overview of Pakistan's current economic state is needed. These figures can help identify current patterns in trade and recognize areas of potential growth.

In international trade, in 2014-15, Pakistan imported nearly 46 billion USD and exported around 23.7 billion USD.<sup>9</sup> The country has been a net importer in recent years. A full set of information including customs codes is available via a Pakistani government document published each year.<sup>10</sup> The largest shares of imports come from China (26.77%), the United Arab Emirates (12.51%), and Saudi Arabia (5.99%).<sup>11</sup> Pakistan generally exports the most to the United States (17.26%), China (8.36%), and the United Kingdom (7.66%), according to government data measuring trade between July 2015 and January 2016.<sup>12</sup> Pakistan's top 10 export partners account for around 60% of exports, according to government data from a 2014-15 survey.<sup>13</sup> The largest share of export goods leaving Pakistan continue to be agriculture-related and thus generally not export-licensable items. However, imports include large amounts of machinery and moderate amounts of chemicals. These could include potentially export-controlled items, depending on the type of object and whether its specifications are listed in Pakistan's national control list.<sup>14</sup> Currently, 95% or more of

<sup>8</sup> Markey, Daniel. "Behind China's Gambit in Pakistan." *Council on Foreign Relations*. 5/12/2016. <http://www.cfr.org/pakistan/behind-chinas-gambit-pakistan/p37855>.

<sup>9</sup> Government of Pakistan. <http://www.pbs.gov.pk/sites/default/files//tables/14.8.pdf>.

<sup>10</sup> Government of Pakistan. "Pakistan Customs Tariff 2015-16."

<http://download1.fbr.gov.pk/Docs/20157101374641856Reupdated5thScheduleandCUSTOMTariff.pdf>.

<sup>11</sup> Government of Pakistan. Jul, 2015 to Jan; 2016. <http://www.pbs.gov.pk/sites/default/files//tables/14.7.pdf>

<sup>12</sup> Government of Pakistan. Jul, 2015 to Jan; 2016. <http://www.pbs.gov.pk/sites/default/files//tables/14.6.pdf>

<sup>13</sup> Government of Pakistan. 2014/15 compiled report. [http://www.finance.gov.pk/survey/chapters\\_15/08\\_Trade.pdf](http://www.finance.gov.pk/survey/chapters_15/08_Trade.pdf)

<sup>14</sup> Government of Pakistan. Last available data is from January 2016. <http://www.pbs.gov.pk/sites/default/files//tables/14.3.pdf>.

Pakistan's freight trade is by sea<sup>15</sup> through three major ports: Karachi, Qasim, and Gwadar (Figure 2).



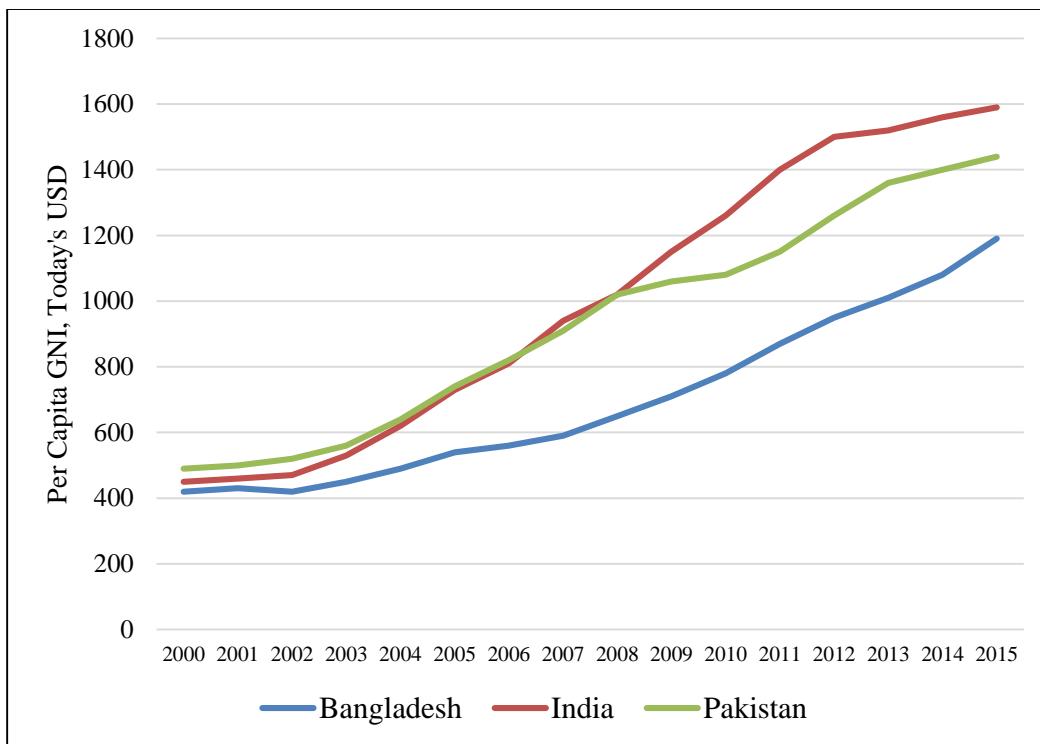
**Figure 2. Locations of Karachi (1), Qasim (2), and Gwadar (3).**

While Gross Domestic Product will be detailed later in this report in terms of potential CPEC effects on Pakistan's overall economic output, Gross National Income (GNI) is also an important indicator of Pakistan and other regional countries' relative economic states. GNI per capita can be valuable in assessing the relative income of a country's average person. GNI figures show a steady increase across the region in relative yearly incomes on a per-capita level (Figure 3). The figures are expressed in current US dollars to provide a common base year and minimize the effects of inflation on the end measurements. Bangladesh, a country that in the 2000's had relatively similar GNI figures, did not grow at as fast of a rate as India and Pakistan. These figures indicate that for Pakistan, there has been a steady expansion in the relative amounts of income the average citizen has made since 2000. This points to a general level of economic expansion, the same case as in neighboring India. Pakistan's credit ratings are somewhat favorable, but often continue to be in the B range. At the time of writing, Standard and Poor's ranked Pakistan at a B level, similar to other rating agencies.<sup>16</sup>

<sup>15</sup> Government of Pakistan, Ministry of Ports and Shipping. Accessed 7/13/2016.

<http://siteresources.worldbank.org/PAKISTANEXTN/Resources/293051-1114424648263/Session-VII-Fazal-Ur-Rehman.pdf>.

<sup>16</sup> Trading Economics accessed 11/29/2016, Pakistan credit rating data.



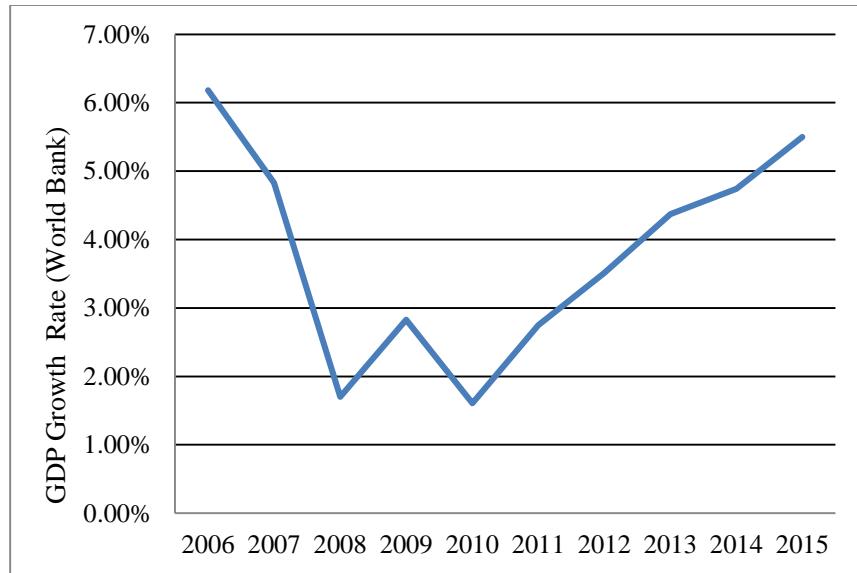
**Figure 3. South Asian Gross National Income Levels, 2000-2015.**

### 1.3 Expansion from CPEC

CPEC and its associated projects are expected to diversify and modify Pakistan's trading activities. Each of the three major categories of CPEC projects—Gwadar port-related developments, land transportation infrastructure, and energy development—can be analyzed in the context of various economic and political effects. This report will focus primarily on the road and port infrastructure projects. All of these developments also intersect other provincial-level politics and internal Pakistani policy debates. The four major Pakistani provinces of Punjab (capital Lahore), Sindh (Karachi), Khyber Pakhtunkhwa (Peshawar), and Balochistan (Quetta) all have economic and political interest in the expansion of regional trade and mobility. Many of the projects introduce simultaneous concerns and opportunities in multiple political and economic arenas. The general expansion of trading activities will also introduce numerous trade security-related concerns.

Pakistan's GDP has been generally on the rise since 2008 (Figure 4 below), led by the increasing success of domestic industries and benefits from technology development.<sup>17</sup>

<sup>17</sup> The data on GDP, GNI, LSCI, and other economic data used in graphs in this report has been accessed through the World Bank's open source database: <http://data.worldbank.org/>.



**Figure 4. Pakistani GDP growth rate.**

Some models suggest that Pakistan's GDP could grow by as much as 15% as a result of the sum total of CPEC funding.<sup>18</sup> This will, if successful, contribute to an already steady GDP growth rate in the country. This includes a 4% growth rate in 2014 and 4.2% in 2015.<sup>19</sup> Pakistan continues to investigate ways to increase its competitiveness and ability to connect with foreign trading partners, and CPEC is increasingly viewed as an important part of that growth strategy by many Pakistani officials. The Government of Pakistan's official website on CPEC explains many of the projects in an official manner.<sup>20</sup>

Broadly, Pakistan does have the theoretical potential to increase trade connections. That can be partially powered by transshipment but would need to be supplemented with domestic growth in exports and overall trade, from Pakistani-origin firms. One economic study<sup>21</sup> of Pakistan's broad outlook in 2015 used the Gravity Model, a leading trade model that can be used to interpret expected trading patterns. The model uses distance between two nations and the GDP of the two trading partners as the main variables to predict overall trade volume. The original version of that model, first used in the 1960's as a trade metric, indicates the simplest relationship between these variables, expressed below. Economists often can change this model to fit specific circumstances.

$$F_{ij} = G \times [(Y_i^a Y_j^b) / (D_{ij}^c)]$$

Variables in the model: F represents total trade volume; G is a constant that can be modified to account for various other variables depending on the study; Y represents a country's GDP or economic strength; i and j represent the two nations; D represents the distance between those two nations; and a/b/c represent other variables economists may assess during the data analysis process.

<sup>18</sup> Ashraf, Sajjad. "China link-up an opportunity and a challenge for Pakistan." 6/2/2015.

<http://www.eastasiaforum.org/2015/06/02/china-link-up-an-opportunity-and-a-challenge-for-pakistan/>.

<sup>19</sup> Asian Development Bank. "Pakistan: Economy." Accessed 7/14/2016. <http://www.adb.org/countries/pakistan/economy>.

<sup>20</sup> Government of Pakistan. <http://cpec.gov.pk/>.

<sup>21</sup> Sultan and Mumir. "Export, Import and Total Trade Potential of Pakistan: A Gravity Model Approach." *University of Central Punjab*. 9/14/2015. [https://mpra.ub.uni-muenchen.de/66621/1/MPRA\\_paper\\_66621.pdf](https://mpra.ub.uni-muenchen.de/66621/1/MPRA_paper_66621.pdf)

That particular study used a modified version of the Gravity Model to take into account the particular outlook of Pakistan and other factors specific to the region. The research concluded<sup>22</sup> that Pakistan does have “untapped export as well as import potential with its border sharing and other trading partners.” This indicates that the structural potential for increased trade does exist for Pakistan.

## 1.4 Pakistan's CPEC Security Strategy

The importance of CPEC to the central government of Pakistan has been clear from the start, and the government is taking numerous precautions to help secure the projects throughout the country. Nawaz Sharif, Pakistan's current Prime Minister, has praised CPEC has an important economic solution that can boost employment figures and reduce poverty in the country.<sup>23</sup> Sharif, a member of the Pakistan Muslim League-N (PML-N) political party, is from Lahore, in the Punjab province, and has been a political player on the provincial level since the 1980's. From 1985 to 1990, he served on the Punjab provincial board.<sup>24</sup> With the support of CPEC comes the need for a security strategy to secure important investments, and Sharif and others have started to develop an implementation plan for project security.

CPEC will be protected by a number of regional and federal agents within Pakistan. Because the security forces will be involved in the port, highway, and energy projects, details of the main force structure will be discussed here as an overview. The security policies will be tailored to individual projects discussed later in this paper, and will be adjusted as different projects progress. The central government of Pakistan has committed to developing a force of some 17,000 people to protect the construction projects and eventually secure the projects throughout the country.<sup>25</sup> The federal force will form a Special Security Division (SSD) exclusively focused on CPEC. The federal forces will primarily be under a two-star general in charge of regional security. One Pakistani general has said the force will be made up of multiple specific military units, and 5,000 of the troops will come from the military branch that already specializes in counterterrorism-related missions.<sup>26</sup> The central government has considered other options to ensure proper security, even recently discussing unmanned aerial vehicles (UAVs) as a potential part of the security architecture. Although they have not committed to using UAVs, some officials have considered them to complement existing efforts.<sup>27</sup>

Because of the threat of separatist and other potentially violent movements in the historically conflict-prone Balochistan province, the Pakistani government has committed to securing the construction of the facilities at Gwadar Port and elsewhere in the region.<sup>28</sup> These policies are

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<sup>22</sup> Ibid.

<sup>23</sup> Dawn, citing PM Office. “CPEC to reduce poverty, unemployment: PM Nawaz.” *Dawn News*. 8/29/2016. <http://www.dawn.com/news/1280710>

<sup>24</sup> BBC. “Profile: Nawaz Sharif.” *BBC*. 9/25/2013. <http://www.bbc.com/news/world-asia-22167511>

<sup>25</sup> IANS/Economic Times, citing Pakistani official. “Pakistan Army vows to protect \$46 billion CPEC 'at any cost'. 6/2/2016. <http://economictimes.indiatimes.com/news/defence/pakistan-army-vows-to-protect-46-billion-cpec-at-any-cost/articleshow/52558875.cms>

<sup>26</sup> Haider, Mateen. “Army's special security division to protect Chinese workers in Pakistan.” *Dawn News*. 4/21/2015. <http://www.dawn.com/news/1177322>

<sup>27</sup> Dunyanews, citing Pakistani government reports. “Govt mulls using drones for CPEC security.” *Dunyanews*. 8/22/2016. <http://dunyanews.tv/en/Pakistan/350311-Govt-mulls-using-drones-for-CPEC-security>

<sup>28</sup> Reuters. “With Billions of Dollars from China, Pak's Gwadar Port Is a Fortress.” 2/8/2016. <http://www.ndtv.com/world-news/to-protect-chinese-investment-pakistan-military-leaves-little-to-chance-1274908>

generally used to keep workers and assets safe, an important step in ensuring smooth construction. China's concerns about the safety of their workers have been assuaged by these security forces, which are in place even before the infrastructure is opened for commercial use. The forces will also be used for general security of the highway and port infrastructure, most likely including in rural areas. Additionally, some individual provinces will have their own security forces primarily to protect highway and ground projects. For example, the northern Khyber Pakhtunkhwa (KP) province has announced that 9,000 security officials will be assigned to securing CPEC-related projects.<sup>29</sup> The provincial government there is in the process of developing operational plans and techniques to aid in these efforts. Other provinces could put in place their own state-specific security mechanisms as well.

## 1.5 Transshipment

Pakistan is expected to become an important hub for regional transshipment as more goods flow through the new infrastructure systems being built in conjunction with CPEC. Dubai and other major regional hubs currently play this role, but with the expansion of CPEC and increased goods transiting through Pakistan from China, Pakistan's role in global trading networks will continue to grow. Although unlikely to surpass the mega port at Dubai, these increases do introduce new opportunities and concerns. There is an association dedicated to increasing freight forwarding activity in Pakistan called the Pakistan International Freight Forwarders Association (PIFFA). PIFFA activities advocate for expanded infrastructure in support of the trade expansion goals.<sup>30</sup> Some of the most prominent potential transshipment routes involving Pakistan are:

1. Goods flowing in and out of China through Pakistan. This would involve the highway and port projects. A Pakistani marine official explained the importance of highway projects in the context of Chinese goods flowing to the Indian Ocean and Arabian Sea.<sup>31</sup>
2. Items being traded from Afghanistan to other Central Asian countries, part of Afghanistan's goal of regional integration.<sup>32</sup>

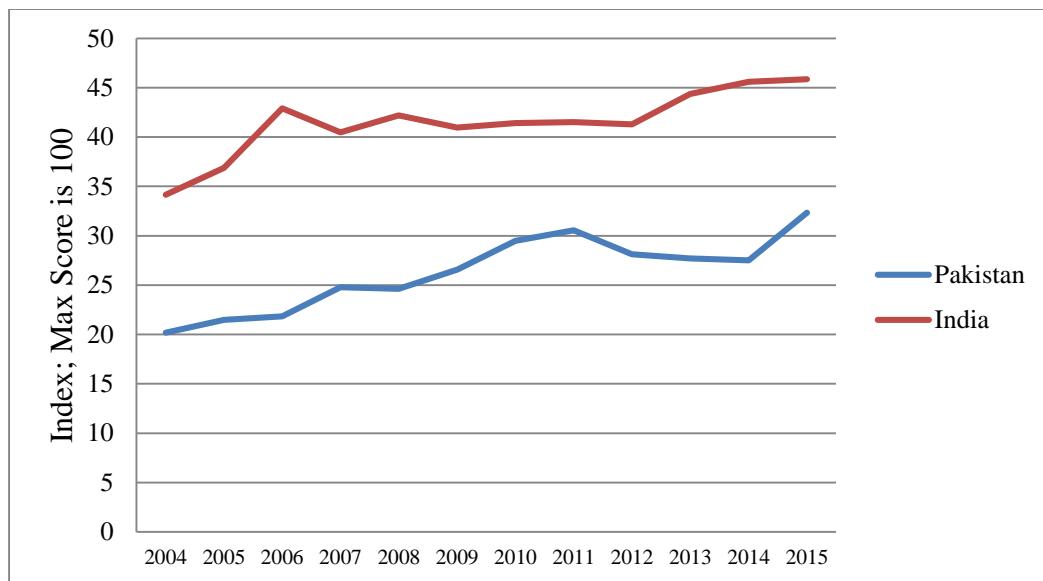
The Liner Shipping Connectivity Index (LSCI) is a data-driven index developed by the United Nations to provide a comparative assessment of how well certain economies are connected to existing global trade networks. It is measured on a 100-point scale and can be used to compare trade volumes and connections within a region or globally. Because the LSCI is a measure of simple connectivity, and does not take into account GDP or other popular economic indicators, it is a valuable way to analyze the pure connections of trade flows. The most modernized and economically integrated economies including Germany, China, and the United States have very high scores on the index, while developing countries tend to be less connected. India and Pakistan both have moderately high scores (Figure 5). For Pakistan, this score will likely increase with the addition of new economic routes and transshipment. The shipment of Chinese goods through the country, as well as the potential import of goods through Pakistan on their way to China, will also link Pakistan to previously under-utilized regional trading partners.

<sup>29</sup> Daily Times, citing KP official. "KP to establish special force for CPEC security." July 15, 2016.

<sup>30</sup> Khan, Asim Saeed, Chairman of PIFFA. "Pakistan as a less than container load (LCL) transshipment hub." Undated. <http://www.piffapk.com/downloads/reports/LCL-byMr.AsimSaeedKhan.pdf>.

<sup>31</sup> Captain Ghulam Mustafa. "Pakistan – An Important Logistics Hub for Transit Trade." Undated. <http://www.piffapk.com/downloads/reports/Article-CaptGhulamMustafa-Waterlink.pdf>.

<sup>32</sup> Ziauddin, M. "CPEC and economic restructuring." *Pakistan Express Tribune*. July 9, 2016.



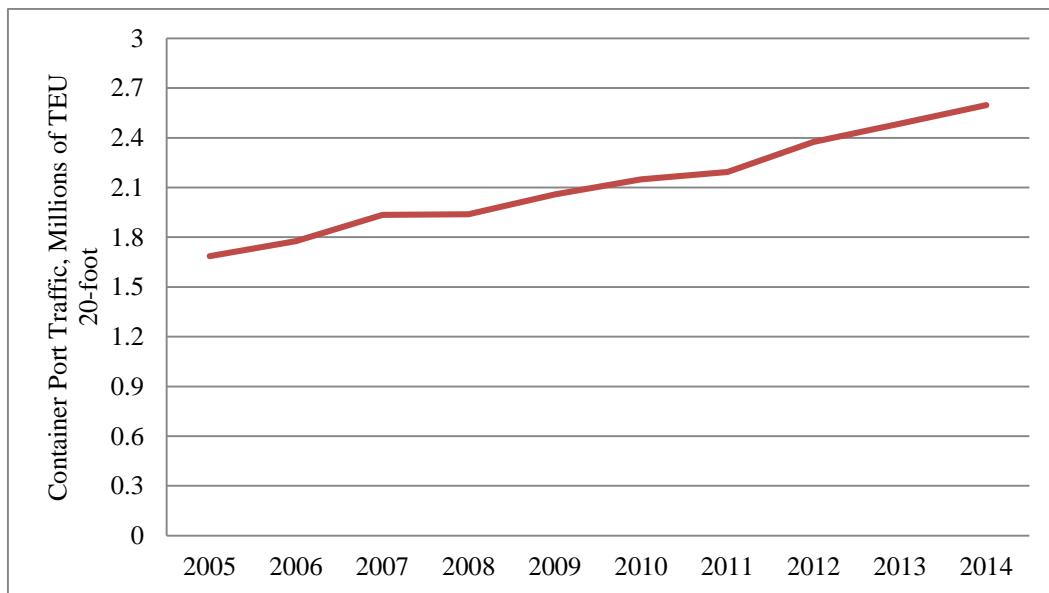
**Figure 5. Liner Shipping Connectivity Index.**

## 2 GWADAR PORT PROJECT

### 2.1 Gwadar Strategic Developments

The Gwadar Port project, a port expansion designed to significantly increase regional trade flows, is one of the most important aspects of the CPEC as it relates to trade security and general economic potential.

The Gwadar Port is located on the Gulf of Oman on the southwest coast of Pakistan's Balochistan Province, making it strategically useful for China from both a trade and geopolitical perspective. An expanded port could also potentially drive increases in an already upward-trending amount of Pakistani container shipping traffic (Figure 6). The port expansion idea is not a new one; the Benazir Bhutto administration stated intent to develop the area as early as 1994.<sup>33</sup> Chinese trading firms and corporations are expected to benefit greatly from the expansion. Early data from 2016 has already shown growth in Chinese exports to Pakistan.<sup>34</sup>



**Figure 6. Annual Container Port Traffic in Pakistan.**

The Gwadar Port is expected to become one of Pakistan's largest-volume trading centers, contributing to an already steadily growing amount of container port traffic in the country. Karachi and Qasim are currently Pakistan's main ports, but their more limited capacity and less accessible location respectively give those ports some disadvantages in trade.<sup>35</sup> Gwadar was originally contracted to a company from Singapore, but now is under Chinese control. In 2015, a Chinese state-owned company began a 40-year lease of the port area as part of CPEC. The company China Overseas Ports Holding Company Pakistan will control the lease, and its three subsidiary

<sup>33</sup> Shah, Mehtab Ali. *The Foreign Policy of Pakistan*. IB Tauris. 1997. Page 89.

<sup>34</sup> International The News. "Chinese exports to Pakistan increase following CPEC launching." 1/15/2017.

<https://www.thenews.com.pk/print/179343-Chinese-exports-to-Pakistan-increase-following-CPEC-launching#>.

<sup>35</sup> Gwadar Port Authority. "Gwadar Port." Accessed July 2016. <http://www.gwadarport.gov.pk/about%20us.html>.

companies will conduct the bulk of the construction at Gwadar. Zhang Bao Zhong is the Chairman<sup>36</sup> of the company. He is also on the Board of Directors at Jiangsu Zhongnan Construction Group, a well-established firm that mainly manages and develops new properties.<sup>37</sup> An analysis of available sources and records suggests that the companies are credible and scandal-free.

Pakistani politicians have been generally optimistic about the potential of Gwadar and its associated infrastructure (Table 1) and the potential benefits of partnering with China's leading economy.<sup>38</sup> China plans to expand trade and maintain valuable energy trading routes for their crude oil imports from Gwadar.<sup>39</sup> China imports over 60% of its oil, and the US government believes that number could be as much as 80% by 2035.<sup>40</sup> There have been concerns about fresh water sources being available to Gwadar, and the government is attempting to resolve this with the construction of a new dam at Sawad.<sup>41</sup> At the same time, locals have expressed concerns at the port development, especially original local fishermen who conduct small-scale operations.<sup>42</sup>

**Table 1. Essential Infrastructure, Gwadar Port.**

Element	Description
Total Expected Volume	1 million tons (by 2017) <sup>43</sup>
Expanded Port Berths for Cargo	Up to 100,000DWT
Natural Gas Terminal	Chinese energy strategy, LNG <sup>44</sup>
Oil Terminals	At least 2 in development, up to 200,000DWT
Airport (City)	Significantly expanded flight capacity

## 2.2 Trade Policies at Gwadar

Although the security force discussed earlier will be tasked with maintaining security of the highway and port infrastructure, a holistic trade security strategy for monitoring the port will need to be executed as the port opens. In addition, Pakistan has investigated new maritime-specific security mechanisms for protection of Gwadar. This includes the adoption of an upgraded Fast Attack Craft (FAC) missile system and vessels that will secure the area surrounding the port.<sup>45</sup>

<sup>36</sup> Karachi Chamber of Commerce and Industry. "Gwadar Port holds immense potential for industrial investment: Chairman COPHC." 3/16/2016. <http://www.kcci.com.pk/PR16-March16.html>.

<sup>37</sup> Reuters Financial. "Jiangsu Zhongnan Construction Group Co Ltd (000961.SZ)." Accessed 7/13/2016. <http://www.reuters.com/finance/stocks/overview?symbol=000961.SZ>.

<sup>38</sup> Business Recorder citing Muslim League-Quaid (PML-Q) leader Senator Mushahid Hussain Syed. "Gwadar port, CPEC will usher in new era of prosperity: Mushahid." 5/24/2016. <http://www.brecorder.com/top-news/pakistan/298033-gwadar-port-cpec-will-usher-in-new-era-of-prosperity-mushahid.html>.

<sup>39</sup> Panda, Ankit. "Chinese State Firm Takes Control of Strategically Vital Gwadar Port." *The Diplomat*. 11/13/2015.

<sup>40</sup> US Department of Defense. "Military and Security Developments Involving the People's Republic of China 2015." 4/7/2015. [http://www.defense.gov/Portals/1/Documents/pubs/2015\\_China\\_Military\\_Power\\_Report.pdf](http://www.defense.gov/Portals/1/Documents/pubs/2015_China_Military_Power_Report.pdf).

<sup>41</sup> The Nation/Pakistan. "Pakistan: Parliamentary Committee on CPEC meets; western route to be completed by August 2018." *The Nation Online*. June 30, 2016.

<sup>42</sup> Meer, Shah. "The Plight of the Gwadar Fishermen." *The Diplomat*. 8/8/2016.

<sup>43</sup> AFP citing Zhang Baozhong, chairman of parent company. "Gwadar port to be operational by year end: Chinese official." 4/12/2016. <http://www.dawn.com/news/1251644/gwadar-port-to-be-operational-by-year-end-chinese-official>.

<sup>44</sup> Jane's. "Sentinel Security Assessment – South Asia." Updated 4/4/2016.

<sup>45</sup> The News International, from Pakistan. "FAC missile inducted into Pak Navy to secure CPEC." 9/18/2016.

The area will also become a free trade zone (FTZ), giving many firms who operate there special tax and other economic exemptions.<sup>46</sup> FTZ's are traditionally delineated physically at port sites and in legal codes that shippers use when moving into a new area. Notably, items in the FTZ will be "customs free" and companies conducting trade-related business in the area will be given a 20-year tax holiday.<sup>47</sup> At Gwadar, these tax exemption policies amount to nearly 40 years of tax-free development in the area, with the main exemptions on income taxes lasting 23 years.<sup>48</sup> A Pakistani government minister has already highlighted the benefits of waiving taxes on entering ships, which currently can amount to as much as 38%.<sup>49</sup> The FTZ policies will likely be under similar trade control regulations as existing Pakistani Export Processing Zones. A set of policies from the 1980's suggests that a description of the type and amount of goods being traded will be required as documentation.<sup>50</sup> Pakistan has also made case-by-case adjustments to some tax policies to benefit Chinese companies engaged in the projects. The Pakistani Economic Coordination Committee (ECC) has made these adjustments by changing specific wording in existing laws, thereby waiving certain taxes a company would traditionally face.<sup>51</sup>

Pakistan has a moderately developed export control framework to ensure safe export of controlled goods, and that system should function for CPEC projects. In the legal sphere, Pakistan's 2004 Export Control Act establishes the legislative basis for controls in Pakistan, and the Strategic Export Control Division (SECDIV) enforces those regulations. Pakistan also has a new training program that as of early 2016 had trained 197 officials who work in trade-related environments. Pakistan's trade security organizations are also developing WeBOC, a new electronic system for customs clearances.<sup>52</sup> These online systems have the potential to streamline the processes businesses and port operators use to track goods and verify the status of trade-related transactions. Although these improvements suggest a continued Pakistani focus on trade security procedures, the potentially substantial increases in trade at Gwadar will need to be monitored.

## 2.3 Effects on Pakistan

### 2.3.1 *Militant Activity*

The Balochistan province, where Gwadar is located, has seen violence driven by separatist and other violent activities for many years. The historically rooted regional conflict, which includes

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<sup>46</sup> Yan, Li. "Groundwork laid for China-Pakistan FTZ." *Global Times*. 11/17/2015. <http://www.ecns.cn/business/2015/11-17/188916.shtml>.

<sup>47</sup> "The Free Zone area will be customs-free and protected by a security fence. All imports shall be subject to the applicable duties and charges if and when they are taken out of the Free Zone except for the purposes of exporting out of Pakistan." Gwadar Port Authority document, January 2014, <http://www.pc.gov.pk/wp-content/uploads/2014/04/PC-1-Free-Zone.pdf>.

<sup>48</sup> Express Tribune. "Pakistan approves massive tax exemptions for Gwadar port operators." 5/24/2016.

<sup>49</sup> AP of Pakistan, citing Minister for Ports and Shipping Mir Hasil Khan Bizenjo. "Ships' registration: tax waivers to help boost shipping business: Hasil." 6/29/2016. <http://www.brecorder.com/business-and-economy/189:pakistan/61455:ships-registration-tax-waivers-to-help-boost-shipping-business-hasil/?date=2016-06-29>.

<sup>50</sup> Export Processing Zones Authority Laws, Rules and Regulation, Pakistan. <http://www.epza.gov.pk/epzaord.pdf>. "Goods cleared for export shall be secured and forwarded to the exporting station under Customs supervision, a pass shall be sent with the goods, specifying the name of the importer and the clearing agent, if any, number of vehicle, description and quantity of goods with the marks and numbers and contents thereof and, on receipt of the goods at the exporting station, the officer of customs allowing the export of goods shall retain the pass"

<sup>51</sup> Express Tribune. "Govt grants concessions to two Chinese companies on CPEC projects." 8/19/2016.

<sup>52</sup> Ministry of Foreign Affairs/SECDIV/Pakistan. "Pakistan's Strategic Export Controls (Latest Developments)." ISSI Seminar, Islamabad. <http://issi.org.pk/wp-content/uploads/2016/05/Zafar-Ali-ISSI-Seminar-XC-NP-3-May-2016.pdf>.

militant groups battling against government targets, could introduce complications for CPEC.<sup>53</sup> Balochistan separatists continue to fight in the region, and they are often in opposition to development projects that are perceived as attempts to gain political influence over the province. These events may affect the development of the port; however, the new security force the Pakistani government has developed is designed to keep project construction and operations online. Pakistani officials have expressed optimism in these coordinated security strategies to support the stability of the Gwadar projects, saying that the increased economic development will empower local communities. Pakistan's current Minister from the planning/development department, Ahsan Iqbal, has stressed that Gwadar is a government priority that can revitalize the region.<sup>54</sup> However, this should be taken with caution because the developments are a long-term project. For Pakistan, maintaining economic stability during construction will be important. The foreign investment is already in place, but Pakistani policies will need to stress regional development that can economically empower the historically struggling province.<sup>55</sup> Overall terrorism deaths in Pakistan declined by 48% from 2014 to 2015, although sectarian-related deaths increased 7% to 272.<sup>56</sup> Activity in Balochistan will continue to influence the feasibility of CPEC projects in that region.

Regardless of the domestic implications, Gwadar is viewed by many Pakistanis as geopolitically strategic outside of just economic engagements—India is nearly 300 miles from the area, making the port less vulnerable than Pakistan's other major ports.<sup>57</sup> The Pakistani military is also using Gwadar as an opportunity for naval expansion and modernization. Pakistan has general concerns about naval build-up near its borders, and it's likely that Gwadar will also intersect these issues. There has been a small Pakistani naval facility, PNS Akram, at Gwadar since as early as 2011.<sup>58</sup>

### 2.3.2 Additional Notes: *Balochistan*

The conflict in Balochistan is historically-rooted and additional background information may be important to understand its current impacts on CPEC and other major events in Pakistan. The conflict is broadly between separatist militant groups in the Balochistan province and the Pakistani government. These conflicts initially began to escalate in the 1940's, and there have been a number of periods of increased violence since then. The inner politics of the province itself, its relationship with Pakistan's central government, and militant group influences have created complications ever since. Since the 1980's, the province has undergone transitions back and forth from civilian to military rule. Most scholars break down the militant escalation into 4 major insurgencies.<sup>59</sup> Many groups in the province, both militant and peaceful, tend to see themselves as not completely culturally or ethnically in line with the general Pakistani population.<sup>60</sup>

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<sup>53</sup> Whalen, Emily. "Balochistan is seething, and that can't make China happy about investing." *Foreign Policy*. 3/31/2016. <http://foreignpolicy.com/2016/03/31/balochistan-is-seething-and-that-cant-make-china-happy-about-investing/>.

<sup>54</sup> Express Tribune. "China-Pakistan Economic Corridor: CPEC to change Balochistan's fate, says Iqbal." 9/23/2016. <http://tribune.com.pk/story/1186749/china-pakistan-economic-corridor-cpec-change-balochistans-fate-says-iqbal/>

<sup>55</sup> Bokhari, Farhan. "Chinese investment spurs action in Baluchistan." *Jane's Intelligence Review*. 1/22/2016.

<sup>56</sup> The News citing independent think tank assessment. "Terrorist attacks kill 1,079 people in year 2015: PIPS report." 1/5/2016. <https://www.thenews.com.pk/latest/86585-Terrorist-attacks-kill-1079-people-in-year-2015-PIPS-report#>.

<sup>57</sup> Kalim, Inayat. "Gwadar Port: Serving Strategic Interests." *South Asian Studies*. Vol. 31, No. 1, January-June 2016, pp. 207-221.

<sup>58</sup> Hardy, James. "Pakistan asks China to take over Arabian coast port." *Jane's Defence Weekly*. 5/27/2011.

<sup>59</sup> Hussain, Zahid. "The battle for Balochistan." *Dawn News*. 4/25/2013. <http://www.dawn.com/news/794058>

<sup>60</sup> Talukdar, Sreemoy. "Balochistan: Pakistan's darkest underbelly and dirtiest open secret lies exposed." 8/20/2016.

## 2.4 Effects on Regional States

### 2.4.1 India and Iran

India broadly is often portrayed to be competing with the CPEC projects, especially with regards to regional Chinese investment. These perceptions are driven by India and China's generally fragile relationship. India and Iran, along with Afghanistan, have agreed to expansion projects at Chabahar Port in southeast Iran. Japan is also interested in potentially partnering with India on the expansion because of the potential for future trade connections, according to its foreign ministry.<sup>61</sup>

Chabahar and Gwadar are similarly positioned for trade. They are both on the Gulf of Oman, serve nations that want to expand trade, and have important connections to the Middle East and Central Asia. However, India has decided to partner with Iran at Chabahar, while China and Pakistan partner at Gwadar. The most recent reports suggest that India will commit 500 million USD to the broader Iranian free trade zone and 20 billion USD to the port and nearby city.<sup>62</sup> Chabahar is not a deep-water port, and Gwadar's expansion to deeper depths will most likely aid in the Pakistani port's success.<sup>63</sup>

As development of the Chabahar Port continues, Iran is expressing interest in CPEC projects too. A meeting between leaders indicates that Iranian President Hassan Rouhani is interested in joining in with CPEC projects for economic development.<sup>64</sup> Pakistan has said that they view the Chabahar Port and Gwadar Port projects as essentially complementary, rather than competitive, according to a statement by a domestic minister.<sup>65</sup>

### 2.4.2 China

CPEC and OBOR broadly are a Chinese economic and political strategy in the region. Although the economic benefits will help both China and Pakistan, Gwadar is also strategically important from a Chinese military perspective. A USG Pentagon report has expressed concerns that China may port certain military vessels at Gwadar, in a partial partnership with Pakistan.<sup>66</sup> There has already been an increase in China-Pakistan joint military exercises, including naval exercises.<sup>67</sup> In addition to the exercises, a nuclear-powered submarine of Chinese origin was seen docked at

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<sup>61</sup> Parashar, Sachin. "Japan interested in Chabahar project." *Economic Times*. 9/8/2016.

<sup>62</sup> Alireza Ramezani. "Iran finds new port partner in India." *Al-Monitor*. 6/2/2016. [www.al-monitor.com/pulse/originals/2016/06/iran-india-modi-visit-chabar-investment.html](http://www.al-monitor.com/pulse/originals/2016/06/iran-india-modi-visit-chabar-investment.html)

<sup>63</sup> Lahore Daily Times Online. "Pakistan Article Discusses Govt's Stance on Foreign Policy, Emphasis on Economic Diplomacy." 7/1/2016. Accessed through Jane's Online.

<sup>64</sup> Times of India/PTI citing official statements. "Iran keen to become part of China-Pak Economic Corridor." 9/22/2016. <http://timesofindia.indiatimes.com/india/Iran-keen-to-become-part-of-China-Pak-Economic-Corridor/articleshow/54462795.cms>

<sup>65</sup> The Express Tribune citing Pakistani Minister Iqbal. "Pakistan does not view Chabahar port as competition." 12/16/2016. *Express Tribune*. <http://tribune.com.pk/story/1264626/quashing-concerns-iqbal-not-view-chabahar-port-competition/>.

<sup>66</sup> The News PK, citing US Pentagon document. "Naval base in Gwadar." 5/21/2016. <https://www.thenews.com.pk/print/121546-Naval-base-in-Gwadar#>.

<sup>67</sup> Dawn. "Pak-China naval collaboration gains more importance due to CPEC." 11/21/2016. *Dawn News*. <http://www.dawn.com/news/1297739>

Gwadar in mid-2016<sup>68</sup>, and China has sold<sup>69</sup> Pakistan two ships to station at Gwadar. Pakistan's Maritime Security Agency, one of the divisions involved with port security, has said that the ships will be used for various search and rescue operations throughout Pakistan.<sup>70</sup>

These increasingly close military connections between China and Pakistan could potentially put Gwadar in the broader discussions that are occurring about naval buildup by China, Pakistan, and India in the region. These military developments could mean that Gwadar intersects other concerns about growing militarization in the region, something that is an important area for future study. Chinese military initiatives are an important part of the 'string of pearls' development, although the genuine Chinese motivations and outcomes may be more complex than simply a set of strategically located ports.

#### 2.4.3 Russia

There have been initial reports that Russia could have interest in trading at Gwadar Port, and Russia has been granted permission to trade out of Gwadar by Pakistan.<sup>71</sup> Amid some controversy on cooperation activities, the Russian Foreign Ministry continued to indicate its general interest in 'strengthening economic cooperation' with Pakistan.<sup>72</sup>

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<sup>68</sup> Hindustan Times. "2016 image shows Chinese nuclear submarine docked at Pakistan port: Sources." 1/6/2017. <http://www.hindustantimes.com/world-news/2016-image-shows-chinese-nuclear-submarine-docked-at-pakistan-port-sources/story-ajFCqONiRP43U1V0Q1RG6O.html>

<sup>69</sup> Aneja, Atul. "Warships sold, not gifted to Pakistan, says China." 1/17/2017. *The Hindu*. <http://www.thehindu.com/news/international/Warships-sold-not-gifted-to-Pakistan-says-China/article17047384.ece>.

<sup>70</sup> Baloch, Behram. "China hands over two ships to Pakistan for maritime security." 1/16/2017. *Dawn News*. <http://www.dawn.com/news/1308491/two-chinese-ships-arrive-for-gwadar-port-security>

<sup>71</sup> The News International. "Russia allowed use of Gwadar Port." 11/26/2016. <https://www.thenews.com.pk/print/167827-Russia-allowed-use-of-Gwadar-Port>

<sup>72</sup> Economic Times. "Russia denies secret talks with Pakistan on China-Pakistan Economic Corridor." 11/29/2016. <http://economictimes.indiatimes.com/news/defence/russia-denies-secret-talks-with-pakistan-on-china-pakistan-economic-corridor/articleshow/55687803.cms>

### 3 INFRASTRUCTURE AND BORDER PROJECTS

#### 3.1 A Land Trading Corridor

CPEC projects that build and/or expand highways and transportation infrastructure are expected to make the transfer of goods between Pakistan, China, and other countries in the region more efficient. CPEC expands existing infrastructure projects in Pakistan that were initially proposed in 2005 as part of the National Trade Corridor (NTC) program (Table 2). This program's purpose is to ensure that policy related to land infrastructure development is internationally competitive and properly planned.<sup>73</sup> The planned road network is intended to connect the southern areas including the Gwadar Port complex to the northern provinces of Pakistan. The expansion will make the transport of Chinese goods flowing to Gwadar more efficient, cutting down on transportation time and allowing for larger trading volumes. However, there are concerns regarding the increase in trade and its intersection with potential border disputes and crossings.

The extensive network is being funded through loans valued at nearly 12 billion USD that generally have an interest rate of 1.6%.<sup>74</sup> Although many of the projects are long-term developments, many of them are already under initial construction.

**Table 2. Principal Active CPEC Transportation Projects.**

Infrastructure Route	Purpose
Karakoram Highway (North)	Thakot-Havelian bridge and infrastructure connectivity improvements
Karachi-Lahore Highway (Large Connection)	Connecting Karachi/Southern Pakistan to the North
Railway Upgrades (Throughout)	31 station upgrades, Karachi-Lahore routing; primarily freight. <sup>75</sup> Other planned improvements for future cross-country routes.

Multiple routes have been proposed for the ground transportation system, but in all scenarios the main corridor will need to pass through the northern portion of Pakistan in order to reach the China-Pakistan border. Because the routes will connect to China's Xinjiang province, the route moves through the Gilgit-Baltistan area and parts of the disputed Kashmir region.<sup>76</sup> This section includes expansion and modernization of the high-altitude Karakoram Highway that currently begins north of Islamabad and navigates the mountains northward into China. India has expressed concerns with these routes that would transit contested territory. So far, the Indian government has been generally respecting of Pakistan's economic ambitions surrounding the projects<sup>77</sup>, but the Kashmir issue could change India's stance.

Eastern and Western routes have been proposed for the infrastructure system—the Western route would go north through Balochistan, while the Eastern version would intersect generally more

<sup>73</sup> PIFFA. "Country Report." June 2012. <http://www.piffapk.com/downloads/reports/PIFFACountrreport.pdf>.

<sup>74</sup> Butt, Naveed citing Pakistani Minister. "Economic corridor: China to extend assistance at 1.6 percent interest rate." 9/3/2015. <http://www.brecoorder.com/market-data/stocks-a-bonds/0/1223449/>.

<sup>75</sup> The Express Tribune. "Public transport: CPEC railway projects underway, says minister." *Express Tribune*. 4/16/2016.

<sup>76</sup> Haider, Kamran. "Pakistan Wants to Become China's Newest Superhighway to Europe." 3/31/2015.

<http://www.bloomberg.com/news/articles/2015-04-01/pakistan-s-sharif-seeks-energy-deals-during-china-visit>.

<sup>77</sup> Singh, Priyanka. "The China Pakistan Economic Corridor and India." *Institute for Defence Studies and Analyses*. 5/7/2015.

populous land in eastern Pakistan. Political strategy plays into the decisions for various routes, as politicians want to build the route through areas that benefit<sup>78</sup> their constituencies. Pakistan's current ruling party, the Pakistan-Muslim League—Nawaz (PML-N) has proposed that the main routes go through Pakistan's most populated province, Punjab. Provincial leaders from KP and Balochistan have both been skeptical of plans to build the main routes through the Punjab region because of the political benefit the leading party would receive.<sup>79</sup>

It's important to note that the final routing has not been fully determined, but routes broadly attempt to connect the southern areas near Gwadar and Karachi to the north, and eventually the Chinese border.<sup>80</sup> The precise location of the northern route will be determined over time, but the rough regional position has been identified (labeled 5 on Figure 7).



**Figure 7. Key Points in CPEC Routes.**

### 3.2 Border Security-Related Concerns

In addition to the potential security-related concerns with transportation infrastructure in Pakistan, activity with numerous border crossings can cause security concerns. This is particularly true with the Afghanistan/Pakistan border, where militant activity is more concentrated. The highest-volume border checkpoint is at Torkham, located in northern Pakistan about 40 miles from Peshawar. In June 2016, there were clashes between Pakistani and Afghan border forces over the attempted

<sup>78</sup> Ali, Manzoor. "Kashgar-Gwadar trade corridor: Chief minister takes firm stance on changes in route." *Pakistan Tribune*. April 23, 2015. <http://defence.pk/threads/kashgar-gwadar-trade-corridor-chief-minister-takes-firm-stance-on-changes-in-route.372412/>

<sup>79</sup> Jane's Intelligence Weekly. "Debate over China-Pakistan Economic Corridor's route indicator of project's momentum, but protest risks will increase." February 16, 2015.

<sup>80</sup> Government of Pakistan, listing of CPEC infrastructure projects in progress. <http://cpec.gov.pk/infrastructure>. Accessed January 2017.

construction of a border gate by Pakistan. Pakistan has advocated for the border gate construction and other security measures because of the risk of terrorists using Torkham to freely transit into Pakistani territory.<sup>81</sup> At the same time, Pakistan has started a visa programs for Afghans seeking medical-related treatments. Those visas will be granted at Torkham.<sup>82</sup>

Pakistan continues to build border check points and gates along the Afghanistan/Pakistan border. They are expected to develop eight major gates, including at Torkham (Table 3).<sup>83</sup>

**Table 3. Pakistan/Afghanistan Proposed Border Gates.**

Checkpoints (from north to south)	Location and Details
Arandu	Northern-most, in Chitral
Nawa Pass	Northern, in the FATA
Torkham	West of Peshawar; mostly completed
Kharlachi	Central/north, near the Kurram River
Ghulam Khan	North Waziristan
Angoor Adda	South Waziristan
Chaman	Central; Balochistan province

### 3.3 Effects on Other Nations

#### 3.3.1 India

India has raised strong concerns over CPEC projects that may flow through Kashmir, a continuously disputed region. In an August 2016 meeting, India's Minister of External Affairs raised concerns to Chinese officials over the infrastructure projects. India's stance on that issue is that Kashmir is Indian territory. Under that stance, India has taken the position that Pakistan occupies Kashmir, meaning that they do not approve of building projects that flow through that area.<sup>84</sup>

Conflicts in the Kashmir region have continued to threaten stability in the region, with an increase in tensions in 2016 that has caused additional concerns. India's current Prime Minister, Narendra Modi, has made controversial statements regarding the status of pro-separatist groups in Pakistan, further adding complications to a conflict resolution mechanism.<sup>85</sup> These comments have added a political element to the conflict that could complicate a short-term political solution.<sup>86</sup> The most recent wave of controversy, although historically rooted, was likely proximately caused by the death of militant leader Burhan Wani on July 8<sup>th</sup>, 2016.<sup>87</sup> Wani was killed by Indian Security Forces, sparking sizeable regional protests. As the leader of Hizbul Mujahideen, a well-known militant group in the region, he attracted a following among citizens.

<sup>81</sup> Khan, Ismail. "Afghanistan and Pakistan Exchange Heavy Gunfire Along Border." *New York Times*. June 13, 2016.

<sup>82</sup> Gul, Ayaz. "Pakistan to Issue Visas to Afghan Patients at Torkham Entry Point." 12/22/2016. Voice of America. <http://www.voanews.com/a/pakistan-to-issue-visas-to-afghan-patients-at-torkham-entry-point/3646590.html>.

<sup>83</sup> Dawn. "Torkham border gate opened to traffic." *Dawn News*. 8/11/2016. <http://www.dawn.com/news/1276815>

<sup>84</sup> Express Tribune citing Indian Minister of External Affairs. "India raises CPEC, NSG concerns with top Chinese envoy." *Express Tribune*. 8/14/2016. <http://tribune.com.pk/story/1162015/india-raises-cpec-nsg-concerns-top-chinese-envoy/>

<sup>85</sup> Kabir, Arafat. "Modi's Kashmir Gaffe Might Be Pakistan's Gain." *Forbes*. 8/22/2016.

<sup>86</sup> Shahid, Kunwar. "The Trouble with Modi's Balochistan Comments." 8/21/2016. *The Diplomat*.

<sup>87</sup> Dasgupta, Piyasree. "Who Was Burhan Wani and Why Is Kashmir Mourning Him?" *Huffington Post*. 7/15/2016.

It should additionally be noted that China has remained on the side of Pakistan in the Kashmir dispute, with one Chinese diplomat stating that Pakistan will be defended by China if “foreign aggression” occurs.<sup>88</sup> This points to continued support from China on this dispute as well as on many other geopolitical issues. Chinese state media has admitted that the ongoing dispute in Kashmir “does hinder” CPEC progress.<sup>89</sup>

### 3.3.2 *Afghanistan*

The Afghanistan/Pakistan border area has been a potential point of conflict since the border was initially drawn. Although CPEC does not directly build projects on this border, the general expansion of activity within Pakistan makes the situation notable for trade security purposes. The Durand Line, which was established in 1893, is what divides Afghanistan and Pakistan, although the view of the border is different based on national perspectives. Its rural location that often is a stronghold for militant groups has complicated matters to secure the border as well. The border activity is an important part of the relationship between Afghanistan and Pakistan.

### 3.3.3 *United States*

The United States, as part of continued counterterrorism-related missions and goals in the region, has encouraged Pakistan to increase counterterrorism cooperation with Afghanistan. The presence of border disputes could potentially complicate these matters, and US officials are urging Pakistan to play an active role in counterterrorism cooperation. A September 2016 US State Department statement<sup>90</sup> made this position clear, explaining that the groups that threaten both Afghanistan and Pakistan require continued Afghanistan-Pakistan cooperation.<sup>91</sup> In addition, American reports continue to cite concerns about reconstruction efforts in Afghanistan. The US Office of the Special Inspector General for Afghanistan Reconstruction (SIGAR) leads these reconstruction efforts and publishes reports detailing American perceptions of Afghani projects.<sup>92</sup>

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<sup>88</sup> Mahmood; Dawn. “China to support Pakistan against foreign aggression.” *Dawn News*. 9/24/2016. <http://www.dawn.com/news/1285774>

<sup>89</sup> PTI citing Chinese State Media Global Times article. “Kashmir dispute ‘hinders’ China-Pak corridor: Chinese media.” 11/18/2016. <http://economictimes.indiatimes.com/news/defence/kashmir-dispute-hinders-china-pak-corridor-chinese-media/articleshow/55492090.cms>.

<sup>90</sup> Testimony of Richard G. Olson, Special Representative for Afghanistan and Pakistan. Wednesday, 4/27/2016. Page 9. <http://docs.house.gov/meetings/FA/FA13/20160427/104867/HHRG-114-FA13-Wstate-OlsonR-20160427.pdf>

<sup>91</sup> Iqbal, Anwar, citing US State Department statement. “US to stay engaged with Pakistan ‘long into the future.’” 9/12/2016.

<sup>92</sup> Bhutta, Zahar citing US SIGAR report. “Afghanistan stands to gain from CPEC option.” 9/25/2016. <http://tribune.com.pk/story/1188230/neighbourly-relations-afghanistan-stands-gain-cpec-option/>

## 4 ENERGY PROJECTS

### 4.1 More Capacity

Energy projects make up the majority of the expected funding for CPEC, and energy development is a major priority for Pakistan. Because of the more pressing trade security-related aspects of the port and transportation infrastructure projects, those are the focus of this report. However, the motivations behind the energy projects are also important for Pakistan's domestic growth. As the population of Pakistan increases and its per-capita GDP rises, there have been generally been major increases in consumption and energy demand. In 1999, per-capita energy consumption was measured at 399 kilograms equivalent of oil by the World Bank. That number reached a peak of 523 in 2007 and was just below 500 in 2013.<sup>93</sup> Pakistan's demand for energy was 4500 megawatts (MW) behind in energy capacity in 2015, and those 4000+ MW shortfalls have been common in recent years.<sup>94</sup>

### 4.2 CPEC Energy Projects

Pakistan's domestic energy supply has not been able to keep up with energy demand in recent years, which has led to frequent outages. As the economy grows even stronger, and manufacturing-related operations continue to be set up, the demand for energy will only increase. CPEC energy infrastructure projects are Pakistan's preferred answer to the current demand/supply differential, as they promise to install expanded capacity in more areas of the country. The long-term goal of these projects is to double Pakistan's energy capacity, a development that will take some time.

CPEC projects on energy intersect multiple types of power, including upgrades to or brand new developments of coal, hydropower, and nuclear power stations. Oil, gas, and coal continue to make up the majority of electricity production in Pakistan. Those three sources have made up over 60% of the domestic portfolio since 1993.<sup>95</sup> The goal of the CPEC projects is to add an additional 10,400 MW of capacity by 2018, which would surpass the status quo shortages (and allow expanded capacity for future economic growth). The bidding for these projects continues to be competitive for Chinese companies due to their lucrative nature.<sup>96</sup>

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<sup>93</sup> World Bank Data. Energy use statistics for Pakistan, accessed August 2016.

<http://data.worldbank.org/indicator/EG.USE.PCAP.KG.OE?locations=PK>.

<sup>94</sup> Tiezzi, Shannon. "China Powers up Pakistan: The Energy Component of the CPEC." *The Diplomat*. 1/13/2016.

<sup>95</sup> World Bank Data. "Electricity production from oil, gas and coal sources (% of total)." Accessed September 2016.

<sup>96</sup> Reuters. "China's Silk Road powers bids for \$1.5 billion Pakistan utility stake." 8/23/2016.



## 5 DISCUSSION AND CONCLUSIONS

### 5.1 Overview

The projects and developments related to the China-Pakistan Economic Corridor pose numerous economic opportunities for Pakistan and other countries. The projects, if implemented in an efficient and timely manner, will boost Pakistan's role in global trading networks and augment Pakistan's GDP growth rate. The infrastructure development is a first step in linking China to the Arabian Sea via an efficient route, enhancing connections between numerous South Asian states, and streamlining transshipment projects through Pakistan. Simultaneously, the expected substantial increases in regional trade and transshipment require an understanding of the trade security implications of CPEC. Pakistan has developed a security strategy for the projects that incorporates both federal and provincial partners. For trade purposes, the Gwadar Port will be designated as a Free Trade Zone, providing the area with economic benefits for foreign traders and manufacturers. Numerous divisions in Pakistan will likely collaborate on a security strategy for Gwadar. Security will also be adapted across the country to attempt to secure new routes, especially those that travel through historically violence-prone areas of the country, including the province of Balochistan. Overall, CPEC projects are an important economic and geopolitical development within the South Asian region. The success of the projects will be dependent on conditions on the ground in Pakistan, especially in difficult to reach regions.

### 5.2 CPEC Concerns and Limitations

The increasingly large-scale nature of CPEC projects has been met with concerns regarding political feasibility. Many have expressed concerns over the robust and geographically expansive nature of the projects and from the potential Pakistani debt that could result.<sup>97</sup> These are discussed under the specific project types in this report, due to the geographic diversity of potential problems. The CPEC routes, especially the highway infrastructure, must transit through increasingly complex territory, and often projects face local opposition. Because of those concerns, CPEC projects are incremental in some areas while they show legitimate promise in others. And although China has generally shown confidence in the success of the initiatives, China is likely to be quick to point out policies that can be adjusted in response to security concerns and/or general project delays. In addition, potential disputes internally in Pakistan could cause delays or disagreements, including between civil and military forces.

The Gwadar Port is the most developed project and has started full operations.<sup>98</sup> The highway network, however, faces difficult working conditions, terrain, and opposition, and is viewed by many as a more long-term connectivity project. Dawn, a leading Pakistani newspaper, released an August 2016 editorial statement encouraging leaders to view CPEC as just one part of a larger effort to rebuild Pakistan's economic competitiveness, not as the only mechanism to do so. The

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<sup>97</sup> Khan, Mushtaq. "CPEC: The devil is not in the details." *Dawn News Herald*. 11/26/2016. <http://herald.dawn.com/news/1153597>.

<sup>98</sup> Dawn. "Today marks dawn of new era': CPEC dreams come true as Gwadar port goes operational." *Dawn News*. 11/13/2016. <http://www.dawn.com/news/1296098>.

editorial criticizes certain Pakistani officials who have spoken of CPEC as the singular thing needed to boost the economy.<sup>99</sup>

### 5.3 Broader China/Pakistan Cooperation

China and Pakistan continue to maintain close international ties, both diplomatic and economic. An area of future research could focus on these ties on a broader scale, and their potential implications for regional security and/or nonproliferation policy. CPEC is just one portion of that overall picture. In the international relations sphere, China has increasingly backed Pakistan, notably with Pakistan's entry request to the Nuclear Suppliers Group (NSG).<sup>100</sup> With the United States being openly supportive<sup>101</sup> of India's entry into that important nuclear trade and security organization, China's decision to back Pakistan's application presents new international implications as well. It remains to be seen whether or not Pakistan and India will gain entry into the NSG.

In the defense sphere, a longer-term 'security pact' is being discussed between China and Pakistan. Pakistani officials have said this document is currently being written in a draft form, with the goal of increasing defense cooperation with China.<sup>102</sup> These defense ties could continue to influence security policies in the region, and this could be an important area of future research. The United States Congress has begun to analyze the China/Pakistan relationship as it relates to the NSG too, including with Foreign Relations Committee discussions.<sup>103</sup>

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<sup>99</sup> Dawn Editorial. "Seized with CPEC." 8/20/2016. *Dawn News*. <http://www.dawn.com/news/1278616/seized-with-cpec>

<sup>100</sup> Hindustan Times citing Chinese government officials. "China says it will support Pakistan's case on NSG entry." *Hindustan Times*. 6/23/2016. <http://www.hindustantimes.com/world-news/ahead-of-modi-xi-meet-china-says-will-support-pakistan-s-case-on-nsg-entry/story-Ity8cHQRPbq3m9ZFwxOHmK.html>

<sup>101</sup> White House Statement. "JOINT STATEMENT: The United States and India: Enduring Global Partners in the 21st Century." 7/7/2016. <https://www.whitehouse.gov/the-press-office/2016/06/07/joint-statement-united-states-and-india-enduring-global-partners-21st>

<sup>102</sup> PTI. "Pakistan cabinet gives go-ahead for negotiating long-term security pact with China: Report." 9/4/2016.

<sup>103</sup> US Senate Committee on Foreign Relations. "Pakistan: Challenges for US Interests." 9/8/2016. <http://www.foreign.senate.gov/hearings/pakistan-challenges-for-us-interests-090816>.

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