

CPEC Industrial Zones and China-Pakistan Capacity Cooperation

Liang Tong *

Abstract

With the China-Pakistan Economic Corridor brought onto the fast track of construction and major political hurdles eliminated, we are expecting to see it progress to the stage where dozens of Special Economic Zones or Industrial Zones are to be established along the corridor. At the same time, China is championing a new concept of economic cooperation - International Capacity Cooperation - spearheaded by Premier Li Keqiang himself. This chronological coincidence is a big opportunity for Pakistan in its effort to uplift the economic performance and national image. Yet, there are some lurking challenges that we have to deal with in a pre-emptive manner to ensure the smoothness of this mutually benefiting cooperation.

Keywords: CPEC, SEZ, Capacity Cooperation, Challenges,

Introduction

May 28, 2015 is destined to be a date on which Pakistan welcomed its fate changer, and 16 years after the day when Pakistan made its way into the nuclear club, a less ground-shaking All Party Conference (APC) finally got some initial success in ironing out the inter-party controversy with regard to the alignment of China-Pakistan Economic Corridor (CPEC), bringing the whole country across the threshold from ‘wrangling’ into ‘working’ mode, also injecting a huge dose of reassurance to the Chinese government and investors, who have for long looked forward to helping Pakistan to stand on its feet economically. Taking into consideration the fragility of the consensus and all the caveats that opposition parties still hold, we cannot say with surety that all the controversy with regard to the CPEC has come to a final

* Liang Tong is Bureau Chief of *China Economic Daily*, Islamabad Correspondent Office.

conclusion, but if we look back and ask ourselves whether there is something that we have gained rather than lost from this controversy, it is that no one in either Pakistan or China now perceives the CPEC through the narrow lens of a network of roads and railways. A consensus has been developed that CPEC is a multi-dimensional mega-project that promises not only to benefit everybody in Pakistan, geographically speaking, but also to improve every aspect of people's economic life.

Eclipsed by the huge sense of relief brought about by the initial solution to the alignment controversy, something endorsed at the APC was, that a working group (the 5th such group under the joint cooperation commission with the already four established groups working on energy, transport infrastructure, comprehensive planning and Gwadar port respectively) would be established and take the lead in deciding upon the exact location of the industrial zones along the CPEC. This paper argues the following points with regard to the industrial zones:

1. Pakistan desperately needs a more developed industry to lay solid ground for its economic takeoff.
2. Industrial zones will be the backbone factors within CPEC to enable Pakistan achieve a high level industrialisation.
3. Industrial zones are a key platform to promote China's recently initiated Capacity Cooperation.
4. Industrial zones have to be prevented from becoming a source of a new round of controversy.

Pakistan Desperately Needs a More Developed Industry to Lay Solid Ground for its Economic Takeoff

Despite all the efforts of Finance Minister Ishaq Dar to defend Pakistan's economic development in the past financial year on launching the Economic Survey 2014-2015, there has been a failure to reach the preset target. As an ordinary citizen from a country which made all the pains and gains to reform its own economy and which enjoys a special friendship with Pakistan, I feel that the decent and moderate economic growth in Pakistan is falling far short of this country's potential and ambition, and it is a sad story that Pakistan is yet to have what can be reasonably called a pillar industry.

According to the Pakistan Economic Survey 2014-15, industrial sector registered only a 3.62 per cent increase, not only far below the development targets set at 6.8 per cent, but also lower than last year's 4.45 per cent growth. Constituting 80 per cent of Pakistan's industry and long perceived a key indicator of economic robustness, large scale manufacturing grew only by 2.5 per cent in the first nine months (July-March) of fiscal year 2015 compared to 4.6 per cent in the same period last fiscal year.

Manufacturing sector, with its multiplier effect down the pipeline of value addition, is the key contributor to employment opportunities, export volumes, and country development. India as a country having premature de-industrialisation has already felt the pain of a lacklustre economic growth without a strong and reliable engine, and it was precisely in an effort to address this problem that India launched a massive campaign of 'Make in India' with a lot of media fanfare. If there is some lesson we can learn from India, it should be that only a strong industrial base will be the solid foundation upon which a country's economy can take off. For a country the size of Pakistan, without a solid industrial base, however rapidly its GDP is growing, it will be doing only high-speed taxing rather than a real take-off, with the economic dividends from non-industrial sectors not strong and sustainable enough to support a shift in a country's economic landscape.

Of course some under-developed countries or unfairly richly endowed countries might have their own unique success stories, but for Pakistan, I see no alternatives but to build a self-sustainable, internationally competitive, and well-patterned industrial base, through a well-planned and well-supported re-industrialisation or high-level industrialisation, whatever name if any we might like to give it. "Self-sustainable" means a robustness and perseverance that always allows Pakistan to hold its economic fate firmly within its own hand, not vulnerable to the vicissitudes of external environment which might be expected if an economy is relying too much on foreign aid or transit trade; "internationally competitive" means the ability not only to satisfy domestic needs, but also to explore overseas market, so that it will contribute to Pakistan's export and tilt the trade balance in Pakistan's favour; and "well-patterned" means an industrial pattern not only

reflective of the supply and demand of the market, but also taking into consideration long-term nation building needs, and a “must have” in such a pattern is one or several pillar industries that can be seen as the postcard of Pakistan.

Industrial Zones will be the Backbone Factor Within CPEC to Enable Pakistan Achieve a High Level Industrialisation

Although the exact number and locations of industrial zones as part and parcel of the CPEC is yet to be decided, and no one can say with certainty which Chinese company or China-Pakistan Joint Ventures will establish their businesses in which industrial zone, one thing for sure is that the dozens of dedicated industrial zones to be established along the routes of CPEC will be an ideal platform where what China can provide will be meeting Pakistan’s needs, and a golden opportunity to enable Pakistan accelerate the aforementioned process of high level industrialisation.

What Pakistan needs from these industrial zones can be seen through a two-pronged approach, with one prong being domestic and the other a regional and international one.

Domestically, Pakistan is a country where one of the world’s most rapid and large scale urbanisation is taking place, and it is expected that during the five-year span from 2015 to 2020, urban population in Pakistan will grow from 71.2 million to 81.2 million, bringing the percentage of urbanised citizens from 37.6 per cent to 39.5 per cent.¹ However, this urbanisation is a comparatively low level and even the few big cities, where population is concentrated, are striving to provide decent housing conditions and employment opportunities, producing a huge swath of population that although geographically urbanised, are not satisfied with their living and economic situation. Left unattended, these people might make a pool vulnerable to radicalisation and even terror recruitment. Yet the positive side of the same coin is a very big gap in the supply of basic needs that can be best addressed through an industrial zone-led re-industrialisation.

On one hand, industrial zones can be a manufacturing hub producing a large amount of goods that directly caters to the ever accelerating urbanisation process and rapidly burgeoning middle class. Having local production replace imports can help bring down price and increase affordability in areas where tariff or transport cost is high. Injection of more advanced technology will also help improve quality and reduce environmental impact in areas where Pakistan already has a reasonably developed capacity.

A case in point is the alternate energy sector like solar panels and wind turbine production, where domestic demand is high due to Pakistan's acute electricity shortage. China is a leading country both in terms of production capacity and in terms of quality to price ratio in these areas. And in truck and construction machinery sector, China has a dozen of world class factories producing very reliable and affordable machines that have long been the backbone of China's infrastructure construction, largely replacing their expensive imported counterparts.

I am a personal witness of the final phase of Metro bus construction. Pakistan deserves congratulations for completing this national project. This project could have been finished earlier. The slow progress of this project was not the result of a lack of devotion from the workers, but because of an acute lack of necessary heavy machinery. Some of the cranes and trucks used in the construction work seemed decades older than the Metro bus project they were building, and I see no reason why the Chinese companies cannot establish some production lines in the industrial zones to locally produce a modern fleet of construction machinery to support Pakistan's uplift of its national image.

Also, in private and commercial use automobile sector, despite the present dominance of Japanese brands, Chinese companies can also enter into the market, as long as we can provide better quality and a reasonably distributed maintenance support network in Pakistan. Since CPEC is a long-term mega-project and the industrial zones will not be finished overnight, China still has a big potential to catch up with Japan's established advantage in the automobile sector.

On the other, industrial zones will enable Pakistan to produce more internationally competitive products, both to improve its engineering image, and to tilt the trade balance more in its favour. Pakistan has been running a significant trade deficit. With a slight reduction in both export and import volume from the previous financial year, Pakistan's trade deficit slightly worsened to 13910 million US dollars in FY 2014-15.² A brief review of the major exported items makes it clear that at the root of this export weakness is Pakistan's lack of internationally competitive manufactured goods and near dominance of raw material or semi-processed goods. Lack of competitive manufactured goods has left Pakistan with no other choice but to import more than it can export, and hampered its ability to fully enjoy the economic vitality from regional economic integration. A major reason why Afghanistan-Pakistan Transit Trade Agreement (APTTA) has been slow in bringing economic benefits is the fear of Afghanistan exploiting Pakistan's industrial weakness by reselling goods imported via Pakistan.

By making industrial zones production the center of high quality manufactured goods, Pakistan will be more favourably positioned in the international trade market. A larger percentage of manufactured goods in export portfolio will not only make it more resilient to changes in market demand and price fluctuation, but also more profitable due to a bigger added value. Chinese investment in Pakistan has always kept an eye on enabling Pakistan to generate its own economic blood, and whenever Pakistan successfully makes its way into international market with products jointly designed and manufactured by our two countries. China feels proud for Pakistan's achievement as well. A shining example of this China-Pakistan cooperation further bearing fruit is the successful sale of JF-17 fighter jets to Myanmar, and we have all the reason to believe that this success story can be replicated in the non-military sector as well, with the help of industrial zones.

Industrial Zones are a Key Platform to Promote China's Recently Initiated Capacity Cooperation

Most actively spearheaded by our Premier Li Keqiang, promoting international capacity cooperation has become a new "business card" of China's economic diplomacy.

In March 2015, at the 4-days long Boao Forum for Asia, Premier Li Keqiang in his one-on-one meetings with the presidents of Indonesia, Armenia, Sri Lanka and Kazakhstan, offered to extend capacity cooperation with these countries respectively. Li's proposal of deep cooperation in infrastructure construction and industrialisation, mainly consisting of China exporting its advanced excessive industrial capacity to countries in need, was warmly received by his interlocutors, even to the extent of being hailed "Project Li" by Nazarbayev.

China did not stop at conducting such cooperation on a bilateral and ad hoc basis, and two months later, China's State Council published directive guidance on promotion of international capacity and manufacturing cooperation, prioritising on countries with high compatibility with China in industrial capacity as well as with a strong desire of cooperation, and focusing on China's advanced industries such as steel, nonferrous metals, building materials, railway, electricity, chemicals, textile, automobile, communication, construction machinery, aviation, shipbuilding and oceanographic engineering. This document draws a blueprint where a group of overseas capacity cooperation demonstration bases are to be established by year 2020, thus creating a favourable environment for the 'One Belt One Road' construction.

Out of the several pages long documentation, a few clauses are worth special attention because they make it clear that this proposal is not just to the benefit of China itself, or as some people have irresponsibly and blindly claimed, to be China's effort to export its heavily polluting and energy guzzling retired industry. On the contrary, any country actively participating in this cooperation will enjoy a "quality guarantee" from China's government, as well as a flexibility in the way of participation so that its own economic interest can be best looked after.

The quality guarantee comes from the document's emphasis on the capability of the companies themselves. As made clear in the document, the investing companies have to do their business in accordance with commercial standards and international practice, make sound analysis of local political, economic, legal and market situation, carry out scientific feasibility study and risk evaluation, and pay special attention to the sustainability of the investment project, with the aim of laying ground for

a long-term, and generally increasing, level of localisation and providing stable and decent employment opportunities to local people.

The document allows for flexibility to cater to different forms of cooperation. Confirming China's traditional advantage in overseas contracting, it encourages investing companies to make full use of their financial and technological edge to actively explore new ways of cooperation, such as 'contracting+ financing', 'contracting+financing+ operating', 'build-operate-transfer', and 'public-private-partnership', where applicable. Encouraging capacity cooperation with more capable countries to further explore the market of a third country, the document gives a blue print for the replication of JF-17's, success story in the civilian sector.

Industrial Zones Have to be Prevented From Becoming Source of a New Round of Controversy

If the controversy that developed around the issue of CPEC alignment has made anything clear, it is that a number of external powers do not want to see Pakistan flourish as a great country with the help of China. They want to torpedo our economic cooperation flagship even before it sails out of the harbour. To achieve this objective, they have ready-to-use hard and soft arsenal.

Camouflaged under the banner of public opinion, relying upon an intensive network of NGOs as bridgeheads, or by directly financing opinion leaders and activists, they try to impact Pakistan's national identity and federation, making each and every political unit engaged in a desperate tug of war to gain the lion's share of CPEC economic dividend, in a hope to delay Pakistan's agreement and postpone China's investment.

With the May 28 APC largely navigating the whole country out of the labyrinth of externally fuelled political wrangling, these external powers will not concede or sit idly. Rather, they will try to grasp each and every opportunity to launch another attack, and industrial zones are an easy prey if no precautionary action is taken. Environmental costs, human rights, labour condition, opportunity equality, each and every thing that

can be categorised under their umbrella of ‘universal values’ will be invoked in a battleground where they are lined up. Their objectives would be to use blackmail and create divisions on the industrial zones. By applying developed countries’ moral high ground unrealistically to a less developed country and creating hurdles for its economic cooperation with a leading developing country, they are doing Pakistan no service. Their purpose is to keep it less well-off economically and less independent politically.

Recommendations

If there is one bulkhead that can be built against the manoeuvres detrimental to both Pakistan and China, it is the timely development of industrial zones. I would suggest the following:

1. Environment cost is inevitable, but not to the degree that China has experienced.

It is common sense that no industry can be pollution-free, and it is unrealistic to expect industrial zones to be 100 per cent environment-friendly. But if we look at the environmental impact of every unit of GDP growth, we are at a much higher starting point than China was when it began its own rapid industrialisation. As the definition of capacity cooperation has made it clear, China will only try to export its advanced excessive industry capacities, which is to say those obsolete capacities will be just retired as they should be, rather than transferred to another country. So when we think of a steel mill being established in a potential industrial zone, it will be a modern and sophisticated one with first-class technology fully applied. Those shabby looking production facilities that China has recently scrapped in some of its northern provinces simply will not be allowed to reappear in Pakistan.

2. The spirit of fairness is more enshrined in opportunity than in outright equality.

Employment opportunity is one of the most anticipated aspects of economic dividend that industrial zones are expected to provide, and in some areas people are expecting industrial zones to enrol exclusively from local labour pool, rather than introducing labour forces either from China or from other provinces. This expectation is understandable in a sense that it allows local people to benefit most from industrial zones. But practically speaking, in order to guarantee the quality of labour force, and thus the operation capacity of the industrial zones, employment opportunities are to be provided on the basis of merit rather than geography, and not ruling out the possibility of recruiting across provinces and creating a migrating labour force in cases where local labour pools are inferior in quality. Empowering and capacity-building efforts will be given priority to help local people catch up in quality and readiness to work in industrial zones. A rigid insistence on outright equality would do no good but to damage overall efficiency, making industrial zones unable to contribute to Pakistan's economy as planned. However, a more flexible approach to uphold the principle of fairness by guaranteeing opportunity equality is more beneficial to Pakistan's development both economically and socially.

3. Labour condition shall not be measured against standards in developed countries.

At the moment, the labour working condition in most of Pakistan's industries is not up to the mark. The establishment of industrial zones will largely change this picture by introducing a whole new standard of labour conditions, enabling our Pakistani brothers to work in a safe and pleasant environment. However, it is not realistic to expect the industrial zones to become a magical wand to elevate overnight the labour condition and labour rights to the standard of western developed countries. Nor is it reasonable to use their standards as benchmark against which to judge the labour right soundness of our industrial zones. Pakistan is a hard-working warrior state where each and every person is fully engaged and devoted to making it a better homeland.

Industrial zones are established to provide more opportunities to build the country, not to consume the country.

With the rational expectation as mentioned above fully developed as a national consensus, Pakistan will be better able to resist external powers seeking to sabotage our economic cooperation, better enjoy the fruits from the tree of Pakistan-China strategic partnership, better flourish as a great power that deserves the recognition and respect from world, *InshaAllah*.

Notes and References

1. UN Population Division data, November 29, 2013.
2. *Pakistan Economic Survey* 2014-15.