Financial Liabilities under CPEC

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There are three main kinds of financial liabilities involved in CPEC:

1- **Fiscal Liabilities** – These include **a)** all debt servicing liabilities (interest payments and debt repayments) brought on by local investments financed through Chinese commercial or government-to-government loans, and **b)** returns on equity guaranteed by the Government of Pakistan (GoP).

2- **Foreign Exchange Liabilities (other than imports) –** These include: **a)** CPEC related debt liabilities (loans repaid to Chinese donors in USD), and **b)** repatriation of profits in the case of FDI projects.

3- **Contingent Liabilities –** These include *potential* liabilities arising from unforeseeable drops in profit rates of FDI (particularly energy) projects below the amount guaranteed by the GoP (Refer GoP's sovereign guarantee agreement).

- The entire energy portfolio will be executed in the IPP mode —as applied to all private power producers in the country. Foreign investors' financing comes under foreign direct investment; they are guaranteed a 17pc rate of return in dollar terms on their equity (only the equity portion, and not the entire project cost). The loans would be taken by Chinese companies, mainly from the China Development Bank and China Exim Bank, against their own balance sheets. They would service the debt from their own earnings without any obligation on the part of the Pakistani government.
- CPEC's second component is infrastructure, which is to be financed through government-to-government loans. As announced, these loans would be concessional with maximum 2pc interest to be repaid over a 20- to 25-year period. This amount's debt servicing would be the Pakistan government's obligation. Debt-servicing payments would rise by $910 million annually on account of CPEC loans (assuming a 20-year tenor). Going by these calculations, we can surmise that the additional burden on the external account should not exceed $2.5bn annually on a staggered basis depending on the project completion schedule. (Based on the calculations of Mr. Isharat Hussain).
- The first set of fiscal liabilities considered were the debt obligations for local investments undertaken by the GoP. These were largely infrastructure related projects.
- CPEC's import component represents a significant source of foreign exchange outflow without any obvious corresponding source of inflow over the immediate period. The import component of CPEC can be quite effectively visualized by looking at total imports from China over the last five years, is—more than doubling from around US$ 7 billion in FY2013 to over US$ 14 billion in FY2017. (A bulk of increase in imports from China post-October 2015 is due to the import of machinery, related to CPEC energy and infrastructure projects).

- The third and fourth areas are Gawadar and industrial development projects including SEZs etc. So all the projects in Gawadar are going to be financed through G 2 G along some grants while industrial development and SEZs are based on PPP, JVs and private sector etc. SEZs and industrial development is the key area along Gawadar port to earn foreign exchange which can play its smooth role in repayments etc.
- CPEC development expenditure will peak at around US$ 430 million in 2018-19 and will decline sharply from then onwards till 2024-25 when CPEC projects being implemented through PSDP will be completed and development expenditure liability becomes zero.
- Repatriation of profits will continue to add to the foreign exchange outflow; in addition to debt servicing and returns on equity paid to Chinese investors (which represent both fiscal as well as foreign exchange liabilities), repatriated profits are a poised to be a significant source of foreign currency outflow post-inception.
- Import of equipment and services from China for the projects would be shown under the current account, while the corresponding financing item would be FDI brought in by the Chinese under the capital and finance account. Therefore, where the balance of payments is concerned, there will not be any future liabilities for Pakistan.

CPEC investments are not all Chinese FDI. On the basis of their financing modes, investments in CPEC related projects can be categorized in the below table:

Investment Category	**Approximate Value (Billion US$)**
FDI	35.3
Public investments financed through commercial or government-to-government loans from Chinese entities	12.8
Public investments financed by Chinese grants	0.4
Public investments financed by non-Chinese foreign loans	0.5
Public investments financed through the GoP’s own resources (revenue or domestic debt)	8.2
Total	**57.2**

Recommendations:

- SEZs and growth sector must start at earliest to consume energy and play role in the enhancement of economic growth and debt repayments.
- The substitution of imported fuels with domestic ones such as; hydro, coal, wind and solar should be able to result in savings of at least $1bn annually. These measures will need concerted action.