

# The Potential Role Of Islamic Finance In Pak-China Economic Corridor Project

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## Abstract

*The China-Pakistan Economic Corridor (CPEC) is a major economic project aimed at building a wide motorway, the railway line from Xinjiang in North-western China to Gwadar in south-western Pakistan. The project is looking forward to building and administer Gwadar Port also. This project will not only shorten the distance for remittance of oil, gas, and other goods to and from China, but also enable China to approach the western world via Gwadar port, which is under construction on the Arabian Sea. According to experts CPEC project will serve as a cornerstone not only in Pakistan-China bilateral Economic & Commercial Relations, but also for the political relationship of both neighbouring countries. In this regard what would be the potential role of Islamic Finance in this project? Or does Islamic finance have the capability to take an active part in this project? If the answer is yes, then how? Subsequently, how it will be better or at least distinguished from the conventional finance? To seek out answers to these questions is the prime concern of this paper.*

**Keywords:** China-Pakistan economic Corridor, Islamic Finance, Monopoly, Sukuk, B.O.T.

## 1. Introduction

China-Pakistan Economic Corridor (CPEC) project, which is considered as one of the major projects of this decade and an axis of growth and development not only for China and Pakistan, but also for the neighbouring countries. Hence, it was unanimously passed by both stakeholders (China and Pakistan) on April 20, 2015.

Under this scheme, a number of inordinate developmental and construction works will be carried out, i.e. 2442 km long motorway from Chinese-controlled North-western Province of Xinjiang to Gwadar in Pakistan's Southern province, fibre optic network, hydroelectric and wind-power along with construction of Gwadar Port, making it functional and its management are the major components of this deal.

Pakistan (as one of the fastest urbanizing countries in South Asia with a population of 207,774,520 which's 63.6% lives in rural and 36.4% is urban areas<sup>1</sup>) has been facing multitude of accumulated crisis, such as power and gas crisis, unemployment, and poverty, which inevitably lead to unrest and riots (GOP, 2017). Therefore, it is hoped that this project which potentially will be built with 62 billion \$ will enable Pakistan to overcome these challenges <sup>2</sup>(Saad Wasim & Saad Wasim 2018) although its initial cost was estimated as 46 billion \$. According to professionals, the project will provide a short land route from

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China to reach the European countries via Gwadar and the Arabian Sea and will pour in an unprecedented occasion of creating substantial magnitude economic and social transformation across the multitudes in Pakistan.<sup>3</sup>

Now it is important to know what the potential role of Islamic finance in the completion of would be such a large project. In other words, is Islamic finance strong enough to play an active role in such game-changing projects? And how its role would be different from conventional finance, and would be more profitable to both countries?

### **1.1 Problem statement**

Like most other (if not all) Islamic countries, Pakistan has dual economic systems: conventional and Islamic. Also, due to the global hegemony of capitalism, the conventional system in Pakistan enjoys the full patronage of the government, due to which the conventional system seems to prevail almost everywhere. In contrast, the Islamic financial system is relatively nascent and private, the entire market share of which, is no more than 15.3% (State Bank of Pakistan, 2020). The remaining 85% is reigned by conventional banking.

In Pakistan, the Islamic financial system generally has not been given a chance to play its essential role in mega projects, and a developing country like Pakistan, which has a conventional economic system that controls over 85% of its economy, and trapped in IMF debts, it is not peculiar if Islamic finance is excluded from the race of building such a great project like CPEC. However, if the Islamic financial system gets a full or partial role in the construction of this great project, then is the Islamic financial system capable of executing its responsibility? Additionally, how different, and better will its role be, in contrast to the conventional system? The purpose of this paper is to find the correct and logical answer to this question based on facts and evidences.

### **1.2 Objectives of study**

1. The objective of this paper is to thoroughly study the origin and evolution of the China-Pakistan economic corridor (CPEC) project, its consequences, and potential pros and cons for both countries.
2. To prove that Islamic finance as a legitimate system is not only the most suitable for any country and project beyond geographical or demographic affiliations but also much better and more beneficial than the conventional financial system.

### **1.3 Research methodology**

Initially, we began with the analytical and descriptive method in order to make appropriate the contents of the article, but during our discussion of Islamic finance and its comparison with its peers, the tinge of the comparative is also reflected in this part of the study, as we mentioned the characteristics of the Islamic finance that distinguish it from conventional systems. Therefore, a summary of the China-Pakistan Economic Corridor, its expected financial implications, and its pros and cons are given. Then a sketchy synopsis of Islamic finance, its features, and axiomatic principles, are discussed.

Therefore, it can be construed that the structure of the study has been constructed on three kinds of approaches, i.e., descriptive, analytical, and comparative. At the same time, the article is expected to highlight the expected role of Islamic finance, its benefits, and being much better than any other economic system in the country's historic and largest project China-Pakistan Economic Corridor.

## **2. Background (Historical Outlines of CPEC, and Why China & Pakistan Need to Build it?)**

Belt and Road Initiative (BRI), also known as One Belt One Road is amongst the largest projects in the world as 124 countries have signed an agreement with China to be associated with it. The project's worth ranges from 1 to 8 trillion and cover almost 30% of the world's GDP.

62% of the world's population belongs to it and 75% of the world's energy resources are linked to this project. This project is consisted of six corridors.<sup>4</sup>

The detail of these corridors is as under:

1. The China-Mongolia-Russia economic corridor.
2. The China-Central Asia-Western Asia Economic Corridor.
3. The China-Indochina Peninsula Economic Corridor.
4. The China-Pakistan Economic Corridor.
5. The New Eurasia Land Bridge Economic Corridor
6. Bangladesh, China, India, Myanmar Economic Corridor.<sup>5</sup>

This project could be potentially divided into two parts i.e., the Lands Economic Belt and the other is the Maritime Silk Road.

But the Pak-China Economic Corridor is the safest and shortest one, has a unique significance that made China calling it the flagship project.

Like many other countries, China is also dependent on the Gulf countries for its petroleum products, and the oil shipping to China passes through Malacca, one of the world's busiest passages. Strait of Malacca is Key Chokepoint for Oil Trade. In recent years, 85-90 % of the total annual flow of petroleum took place through this chokepoint.<sup>6</sup>

The Chinese president for the first time has introduced the term state of Malacca dilemma in 2003, which probably denotes the Chinese concerns over the presence of the large number of troops of powerful countries in Malacca State and their political influence on Malacca's policies can create snags for China, especially in any unforeseen situation. (i.e. in any unfavourable circumstances rival countries could easily cut off China's supply line to shut down China). In addition, energy (oil and gas) shipment must travel 13,000 km to reach China, which in itself is a long, expensive, and time-consuming process. With the completion and functionality of the CPEC and having a reliable alternative route, China will be relieved of the expected hassle by powerful players, as energy will be remitted to China through 2500 km distance, instead of 13000km. It will enable China to save huge expenses and a distance of 10500 km. Similarly, any Shipment in case of an emergency which usually takes 45 days will be reduced 10 days period.

Similarly, it will help China in developing its western provinces. These provinces, especially the Muslim-majority province of Xinjiang, are relatively underdeveloped. Where periodically freedom movements arise, and China has been suppressing them very often in a very cruel way. Now, China believes that with the development of these areas, the people will prefer to live in peace, enjoying the development rather than fighting.

Another important point is that China and Pakistan through CPEC will have easy access to CAR countries i.e., Afghanistan, Armenia, Azerbaijan, Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan, and Uzbekistan. Central Asian Republics have abundance of energy, but due to their geographical location, they cannot enjoy proper access to world markets as they are landlocked countries. For example, a small strip of Afghanistan namely Wakhan (the width at some places is 13 km only) separates Pakistan from Tajikistan. Once the road is built, Tajikistan would have a great opportunity to import its gas and oil to the world market.

At this junction, we should notice that under the One Belt One Road initiative, to get a leveraged political influence and maintain its active role in the polity of the region, China will simultaneously try to tame neighbour countries, like Bangladesh, Malaysia, and Indonesia by investing money and establishing new developmental and commercial projects, as every emerging superpower has to do so. China has a problem with its

increasing influence in regional countries. For the past two decades, Pakistan faces two major problems i.e., energy crisis and terrorism. Due to collective efforts of its government, security forces, religious scholars, and the nation, Pakistan has succeeded in eradicating terrorism, but the energy crisis has not yet been overcome. This project will provide Pakistan an opportunity to get rid of this problem as the major chunk of this project 34 billion \$ has been allocated for energy projects, which potentially adds 16500 megawatts to the country's national grid and rest of amount is reserved for the infrastructure project.

2. Although the country's previous government paid considerable attention to improving the infrastructure, yet a lot of work needs to be done, this project will help Pakistan to make its infrastructure better.

3. Pakistan is one of the countries with a large young population. The new generation is facing unemployment despite graduating from reputable educational institutions. To accommodate such a large number of young people, it is necessary to increase the national GDP up to at least 10-12%. The completion of CPEC is expected to provide a good opportunity to Pakistan in this regard.

### **3. Literature review (Rational of the Study)**

The CPEC project has attracted a large number of scholars, researchers and analysts' attention since its inception. As a result, many books and research articles have been devoted to its commercial magnitude, and political and diplomatic implications, on both regional and international level, for instance: CPEC: Challenges and opportunities for Pakistan,<sup>7</sup> China Pakistan Economic Corridor (CPEC): Prospects and challenges for regional integration,<sup>8</sup> Cyclopentenyl cytosine (CPEC): an overview of its in vitro and in vivo activity.<sup>9</sup> CPEC investment pushed from \$55 b to \$62 b <sup>10</sup>, Impact of CPEC on regional and extra-regional actors <sup>11</sup> Understanding China's Belt & Road initiative: motivation, framework and assessment,<sup>12</sup> Chinese views and commentary on the 'One Belt, One Road' initiative,<sup>13</sup> and Examining the debt implications of the Belt and Road Initiative from a policy perspective,<sup>14</sup> and China-Pak economic corridor (CPEC) and its geopolitical paradigms, are worthy to speak of ,yet a serious examination of its social, cultural, and religious consequences is still to be done. But in all these literatures, all researchers have used analytical methodology and talked about the political and financial implications of CPEC and the national and international challenges and security concerns facing both countries in completing this project. For example, Akbar Ali has written that in the way of completion of this game-changer project, how will the western part of the country be protected from terrorist organizations?

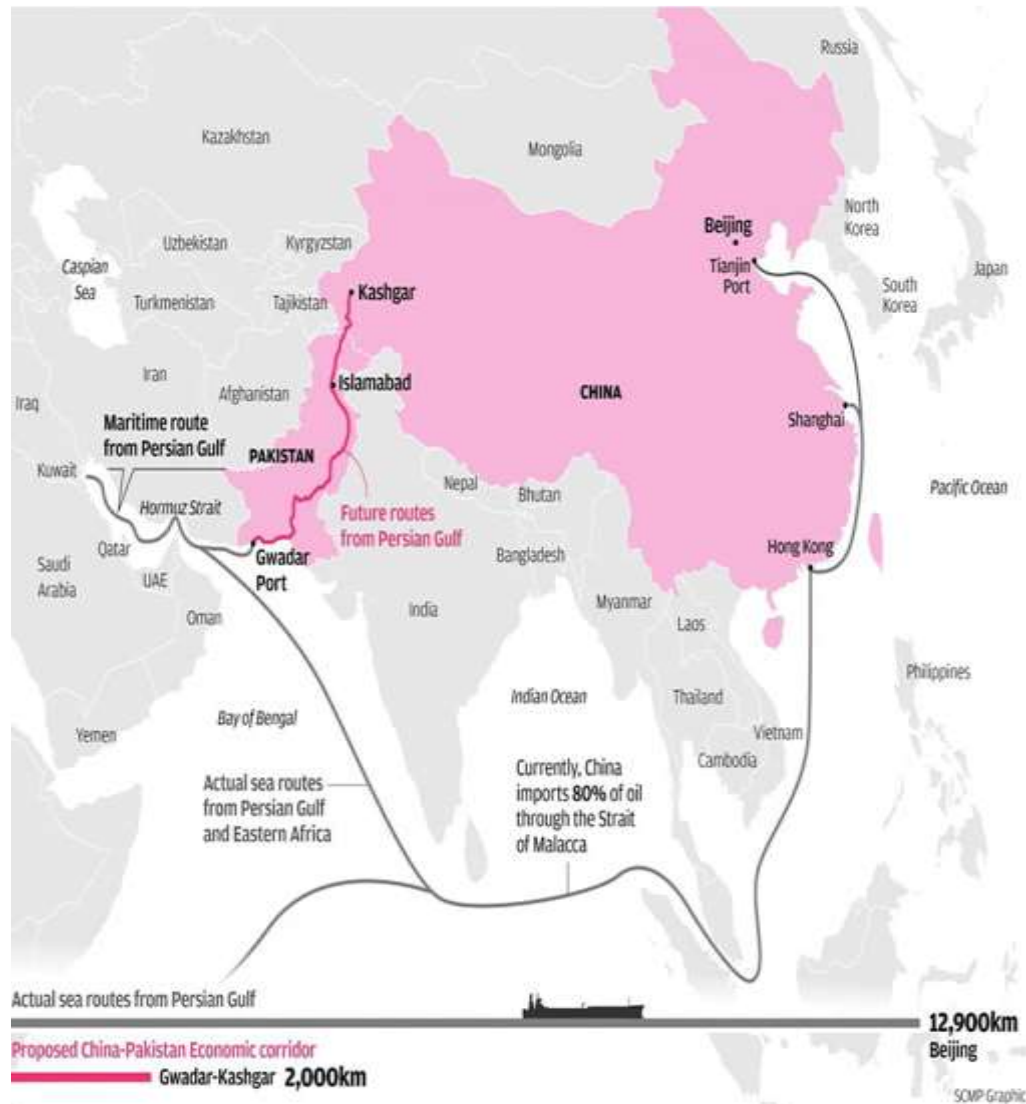
Other scholars have discussed the national and international impact of CPEC. KJMC while Discussing CPEC's Vitro and Vivo, he mentioned how national and international, in his words, regional and extra-regional actors would react to the project.

Why and how the financial volume of this project has increased from 55 billion to 62 billion? Siddiqui Salman has made it reason **d'être** for his research.

And a few other scholars, especially those who belong to China's trade or political rival countries, have weighed in on their research against CPEC. And Some scholars even have not cared a hang for academic ethics, conditions, and boundaries.

On the other hand, Islamic finance has been fortunate and well-served one, despite being relatively nascent however, emerging in its current form, there is hardly a corner left that has not been well worked on in Arabic, Urdu, English or any other language. Yet the potential role of Islamic finance in the context of the CPEC project has not yet been discussed, academically.

This study is thus going to fill the gap by discussing the potential role of Islamic finance in the context of the largest project in the history of Pakistan: an unexplored subject according to the researcher knowledge.

**Figure -1:** Map of the anticipated CPEC and the current energy transportation:

Source: Dawn (May, 2015)

#### 4. Discussion

##### 4.1 Why does Pakistan should choose Islamic finance?

CPEC is the largest and game-changing project in the history of Pakistan, which undoubtedly has the potential to change the entire region's fate, provided that it is completed on time and all necessary actions are precisely taken. It is also a fact that the larger a project is, the more significant are its pros and cons. Therefore, although CPEC could be a developmental milestone project for the country, slightest negligence can be detrimental due to which Pakistan has to work very keenly in this matter.

As we live in the age of propaganda and media war, a lot of disinformation is rapidly being spread by the rumours to draw a spoil picture of such projects in the eyes of the people. It is done to spread malice and concerns among the people and consequently, the government would be stripped of public support. The best cure for such a problem is to restore public confidence and unwavering support, the government should preserve the right of access to accurate information. Being the largest project in history, CPEC faces the same propaganda of war. Hence, people often express a fear that the CPEC would not be an East India Company for Pakistan. As that was also a commercial, which came to united

India in the form of a commercial company, and gradually expanded its influence, by recruiting its own army, building logistic areas occupies the whole country.

Therefore, if CPEC is built on public-private partnership and Islamic finance would have been given a chance to play its essential role therein, it would have been more democratic way, as Islamic finance likely does not represent a specific country or region, rather it is as this would have given the investors from all over the world, including Pakistan, the best opportunity of a sound invest, as the competition would have resulted in better work at lower costs,) as well as it would have been an easier response to the concerns of the people.

According to these critics the lack of public-private participation in the CPEC project consolidates this concern, as the project is monopolised either by China-based companies or companies their identification is not so cleared.

On the other hand, China's lease for 99 years due to non-repayment of loan after construction of the Sri Lankan port is also presented in support of this argument. It is also worth mentioning here that according to the Pakistan CPEC Authority, the project is based on public-private partnership, so, any company from all over the world and including international financial institutions i.e. IMF, World bank and Asian development bank etc. are welcomed to partake in this project, provided they meet the conditions of the project.<sup>15</sup> On the other hand, the Chinese ambassador said responding to allegations made by a senior US diplomat regarding CPEC in a statement that would also gladly welcome American investors. As in his own words: "CPEC is open to investment from anywhere in the world and China would happily welcome U.S. investment in it".<sup>16</sup>

Now, if Islamic finance is made a partner in this project, the concerns about the country's integrity will automatically disappear, because the Islamic finance system does not believe in the supremacy of any country, nation or area, rather than it addresses humanity in general.

#### **4.2 An Introduction to Contracts Through Which This Project Could be (potentially) Financed**

As we mentioned earlier that Islamic finance via its various contracts is suitable for financing, construction projects and long-term infrastructure such as CPEC, also it can be used to finance working capital.

The contracts through which the CPEC project could be financed are as follow:

1. Build, Operate and Transfer,
2. Output/Revenue Sharing,
3. Reversed Murabahah,
4. Corporate Murabahah Line of Credit,
5. Musharakah, Overdraft Financing, and
6. Istisna' Finance to Government's infrastructure projects.

Although, each and all of these contracts are suitable to finance the CPEC project but since the purpose of this paper is to highlight the prevailing method in writing academic articles and researches, rather than absorb Islamic contracts and discuss their jurisprudential status, we will be at the tip of the iceberg, mentioning only usually Build, Operate, and Transfer BOT contract and its Shari'ah compliant implications as it is commonly used for financing large projects such as CPEC.



### 4.3 Bill Operate Transfer (BOT)

This is a contract for building a project on finance from the construction company or builder or finance supporter of the builder) against the right of operating it, by the same construction company for a period of time after which the project is transferred to the beneficiary. This contract is similar to a contract developed during the Ottoman era known as Al-Hukr. Hukra was used to develop endowment properties in the Ottoman Empire. In Al-Hukra, the trustee of the endowments allows the developer to build its construction on the endowment land in exchange for a permanent right granted to the latter to operate the project with a small periodical rent paid to the endowment (Waqf) and establish its construction on the Waqf land against a permanent right.<sup>17</sup>

### 4.4 Modus Operandi of BOT

Under a build-operate-transfer (BOT) contract, an entity—usually a government—grants a concession to a private company to finance, build and operate a project. The company operates the project for a period (perhaps 20 or 30 years) with the goal of recouping its investment, and then transfers control of the project to the government. BOT projects are normally large-scale, Greenfield infrastructure projects that would otherwise be financed, built, and operated solely by the government. Examples include a highway in Pakistan, a wastewater treatment facility in China and a power plant in Philippines.<sup>18</sup>

### 4.5 Shari'ah Bases

B.O.T process has two adaptations: The first: Ijarah i.e. The state leases its land to the manufacturing party for an agreed period for building and hence using its revenues for a specific period of time, and the fee is deferred, which is the same project that will be delivered to the state by transferring its ownership to it at the end of the process. On this adaptation, the project is owned by the manufacturer after its construction, then its ownership is transferred to the state, and it is a fee for the use of land during the contract period, so the relationship between the state and the manufacturer is the lessor's relationship with the lessee.

The second juristic adaptation is: "The state requests the construction company to build the project, hence the contract between the two sides is Istisna, where the state is the Mustasni(project seeking party), and the other side is the Sani (manufacturer/ builder)." The price of Istisna is the revenues that shall be given by the project when it will be operating, as the manufacturer remains a beneficiary of the project over the state property.

This relationship between the two sides will continue until the project is completed, then the Sani (manufacturer/ builder) will continue to benefit from the project for an agreed period that has been specified by both parties at the beginning of the contract.

And according to Abdusstar Abu ghuddah this contract may also be considered as a Jualah contract (ju'alah (also spelled ju'ala) is a contract whose subject matter is a work or task to be done).<sup>19</sup>

It should also be kept in mind that there are some minor issues regarding the jurisprudential approach or legal position of the BOT contract, such as a lease, Istisna or Juala contract. However, since analysing of jurisprudential aspects of this contract and evaluation of scholars' opinion has not been envisaged by the paper we will not address these issues.<sup>20</sup>

## 5. Conclusion and Recommendations

This study has reached the following conclusions after investigating both the CPEC project and Islamic Finance in detail.

1. CPEC is a game-changing project not only for Pakistan and China but for the entire region. The economic future of the entire region depends on it, so every effort should be made to complete it promptly and ensure its transparency, impartiality, and business image.

2. Local Pakistani companies may also be allowed to participate in the project as much as possible because, it safeguards the interest of the people, flourishes local trade, and keep the rival powers or critics away to have the opportunity to propagate against it.
3. Participation of private companies in the project should be done following the principles of Islamic finance.
4. Scholars belonging to various subjects i.e., Economics, Business, Social Studies, Political Science, etc. May be encouraged to Conduct research on CPEC from different angles and write M. Phil Ph.D. dissertations.
5. Information regarding CPEC is available only in English on its official website, where most Pakistanis do not know English language, therefore, the authorities may provide the necessary information in Urdu as well.

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