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Issue Brief

CPEC Phase II and China-Linked Supply Chains in Pakistan

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Summary

CPEC Phase II marks a transition from infrastructure connectivity to industrial embeddedness, through which China could acquire longer-term influence over Pakistan's manufacturing base, technology choices and supply-chain orientation.

The Long-Term Plan for the China–Pakistan Economic Corridor (CPEC) (2017–2030), released in December 2017, envisaged a shift beyond the early harvest phase of roads, energy and Gwadar-linked infrastructure towards industrial cooperation, SEZs (Special Economic Zones), agriculture and socio-economic development.[1] Pakistan's Board of Investment (BoI), a dedicated Project Management Unit for CPEC industrial cooperation, has been operating since 2019.[2]

On 16 January 2026, the BoI announced that the number of approved SEZs under CPEC Phase II had increased from 7 to 44, including 37 newly notified zones. The briefing placed SEZ-led industrialisation and Pakistan–China business-to-business cooperation at the centre of the upgraded CPEC framework. The briefing linked CPEC 2.0 with Pakistan's 'Uraan Pakistan' 5Es framework—Exports, E-Pakistan (digital economy, IT, connectivity and digital governance), Equity and Empowerment, and Energy and Infrastructure, and Environment. It also flagged 2026 as a year of expanded investment outreach, as Pakistan and China plan to leverage the momentum of marking 75 years of diplomatic relations.[3]

The movement from Phase I to Phase II has been slower than expected. The reasons included Pakistan's worsening power-sector liabilities, broader macro-economic stress, investor-service gaps within SEZs, and recurring attacks on Chinese personnel, all of which made Beijing and Islamabad more cautious about shifting from construction-led projects to deeper industrial integration. Only in September 2025 did Pakistan and China formally re-launch Phase II with renewed political emphasis.

The significance of the January 2026 announcement lies not merely in the numerical expansion of SEZs, but in the deeper strategic shift it reflects. CPEC Phase II marks a transition from infrastructure connectivity to industrial embeddedness, through which China could acquire longer-term influence over Pakistan's manufacturing base, technology choices and supply-chain orientation. Phase I of CPEC was centred on roads, energy projects and Gwadar-linked connectivity. Phase II seeks to build industrial clusters, attract anchor firms and integrate Pakistan more closely into China-linked production networks. If even a limited number of these zones become viable, CPEC will no longer be just a transport and energy corridor; it will evolve into an industrial ecosystem.

[1] **"Long Term Plan for China-Pakistan Economic Corridor (2017–2030)"**, Ministry of Planning, Development and Reform, Government of Pakistan, 2017.

[2] **"Project Management Unit (CPEC-ICDP)"**, Government of Pakistan.

[3] Khurram Husain, **"Power Sector Circular Debt Falls by Rs 9bn in April"**, *Dawn*, 21 June 2025.

From Infrastructure to Industrial Embeddedness

CPEC was launched as a flagship Belt and Road corridor to link China's Xinjiang to the Arabian Sea via Pakistan. Over time, it has been packaged as a roughly US$ 70 billion portfolio.[4] In practice, its first phase concentrated heavily on energy generation, transport infrastructure and port-linked connectivity. These projects helped address some of Pakistan's electricity shortages and logistical constraints. Still, they did not resolve the country's deeper structural weaknesses, such as low export competitiveness, weak industrial upgrading and persistent foreign-exchange stress.[5] That is precisely the gap that Phase II now claims it will address.

Phase I also left behind significant financial liabilities. Pakistan's power sector became weighed down by fixed capacity payments, transmission losses, poor recoveries and circular debt. *Dawn* reported in May 2024 that circular debt in the power sector had crossed Rs 2.636 trillion.[6] National Electric Power Regulatory Authority's State of Industry Report 2024 further noted that a recovery rate of only 92.44 per cent added Rs 314.51 billion to circular debt during FY 2023–24, while excessive transmission and distribution losses added another Rs 276 billion.[7] These figures matter for Phase II because industrial zones require predictable and affordable electricity.

A major share of CPEC Phase I was concentrated in power projects built on Independent Power Producer (IPP)-style contracts that guaranteed returns through capacity payments. As a result, Pakistan had to keep paying producers even when electricity demand remained low. Since many of these payments were dollar-linked, rupee depreciation made the burden even heavier in local currency terms, pushing up tariffs or forcing the government to borrow and subsidise the system. Although Islamabad is now re-negotiating some IPP contracts to reduce this burden, the immediate relief is likely to remain modest unless it also addresses payments tied to state-owned and Chinese-backed power projects.

These constraints intersect with Pakistan's export problem, which is central to the Phase II pitch. World Bank data shows Pakistan's GDP at about US$ 371.57 billion in 2024, while exports of goods and services were around US$ 40.2 billion, a weak ratio by regional standards. Islamabad, therefore, presents SEZs as instruments to

[4] **"China Global Investment Tracker"**, American Enterprise Institute.

[5] Aasim M. Husain, **"Rescuing Pakistan's Economy"**, Atlantic Council, 1 April 2025.

[6] Shafqat Hussain Memon, **"Revamping Pakistan's Power Sector"**, *Dawn*, 17 February 2025.

[7] **"Power Division Says Nepra Report Ignores Rs 780 Billion Reduction in Circular Debt,"** *Profit*, 27 February 2026.

expand manufacturing, jobs, tax revenue and foreign exchange. Yet exports will not rise through zones alone without broader reforms to customs efficiency, port operations and ease of doing business.[8]

Why SEZs Matter

The strategic significance of SEZs lies in the kind of dependence they can generate over time. Many actors can use a road. A power plant can be renegotiated, refinanced, or politically contested. But an industrial ecosystem is harder to unwind. According to KPMG, when Chinese firms become anchor tenants in industrial zones, they often bring not only capital, but also machinery, production processes, software systems, spare-part supply chains, after-sales service arrangements, vendor ecosystems and managerial practices. Local firms and labour markets then adapt around those systems.[9]

This can create six overlapping forms of dependence. First, technology dependence, because machinery, operating systems and technical know-how may remain Chinese-sourced. Second, standards dependence, because industrial production often locks in specific technical standards and equipment specifications. Third, supplier dependence as local value chains begin to revolve around Chinese components and service contracts. Fourth, financial dependence, where investment, maintenance and expansion remain linked to Chinese credit or joint-venture structures. Fifth, market dependence, if the zone's commercial viability relies on Chinese buyers, logistics channels, or re-export networks.

And sixth is human-capital dependence. Pakistan does not yet possess the depth of technical skills required to operate, maintain and upgrade many advanced Chinese industrial, digital and renewable-energy systems at scale. This is one reason why CPEC-linked cooperation has increasingly included vocational and technical training, skills partnerships and industry-education linkages. Such training is not a neutral supplement to investment. It can broaden China's long-term footprint in Pakistan by bringing in more Chinese instructors, technical supervisors, partner institutions, curricula and certification linkages tied to Chinese equipment and production processes. Recent China–Pakistan planning documents for 2025–2029 explicitly call for stronger cooperation in technical and vocational education, while

[8] **"2025 Investment Climate Statements: Pakistan"**, U.S. Department of State, 2025.

[9] **"Rethinking Supply Chains in Asia Pacific: A Study on Supply Chain Realignment and Competitiveness Across High Growth Markets"**, KPMG, October 2021.

Pakistan has also expanded CPEC-linked skills initiatives for Phase II.[10] In this sense, Phase II is not only about production, it is about embedding Chinese industrial systems more deeply into Pakistan's economy.

As of now, Pakistan's SEZ framework is based on its own SEZ Act of 2012 and BoI-led one-stop-shop model, not on the Chinese 'Global Value Chain' standard.[11] And, according to the World Bank, many Pakistani SEZs lack basic features such as one-stop services, customs offices and dedicated utility connections. Furthermore, many lacked sewerage systems, dedicated electricity, water and gas connections, and on-site services required under the SEZ Act. This is precisely the feasibility problem that any serious assessment of CPEC Phase II must address. This is important because SEZs create a durable influence only when they are operationally viable.[12] This is why the jump from 7 to 44 approved SEZs must be treated with caution. The more relevant question is which zones are actually moving towards operational readiness and attracting serious investor interest.

Pakistan faces another challenge in financing CPEC Phase II. It wants more Chinese investment, but it is also under IMF-backed reforms that require greater debt transparency and closer monitoring of liabilities and guarantees. This creates tension for Islamabad. On one side, it needs Chinese capital to advance CPEC 2.0; on the other, it must assure the IMF and other lenders that its debt obligations and guarantees are clearly disclosed and managed. The IMF is not opposing CPEC itself, but opaque or off-budget commitments linked to Chinese projects are becoming harder for Pakistan to manage under its current macroeconomic programme.[13]

Beyond economic dependence, some of the sectors of CPEC Phase II carry potential security implications of their own. Emerging areas of cooperation, such as EV assembly, solar value chains, digital infrastructure and minerals-related capacity building, are not strategically neutral. They are part of the wider ecosystem of dual-use and critical technologies that shape industrial resilience, energy security, data control and long-term defence-industrial potential.

The CPEC website highlights a smaller set of priority or more advanced SEZs: Rashakai (Khyber Pakhtunkhwa), Allama Iqbal Industrial City (Punjab), Dhabeji

[10] **"Action Plan 2025–2029"**, China–Pakistan Economic Corridor, CPEC Secretariat, Government of Pakistan.

[11] **"Board of Investment Pakistan"**, Government of Pakistan.

[12] **"Assessment of Special Economic Zones in Pakistan: Suggesting Steps Towards Improved Performance"**, World Bank, 2020.

[13] **"Pakistan: First Review under the Extended Arrangement under the Extended Fund Facility, Requests for Modification of Performance Criteria, and Request for an Arrangement under the Resilience and Sustainability Facility—Press Release; Staff Report; and Statement by the Executive Director for Pakistan"**, International Monetary Fund (IMF), 2025.

(Sindh), and Bostan (Balochistan).[14] The January 2026 briefing also pointed to progress on the Karachi Industrial Park, early work on a Gilgit-Baltistan SEZ, and approval of a land-lease policy for BQIP (Bostan Quetta Industrial Park).[15]

These zones matter for different reasons. Rashakai is promoted as a manufacturing and logistics zone located near key transport routes in Khyber Pakhtunkhwa. Allama Iqbal Industrial City benefits from being in Punjab, near established industrial clusters and supply networks. Dhabeji draws value from its location near Karachi and major port-linked logistics. Bostan is meant to bring industry to Balochistan, but progress there is usually harder because the province has weaker industrial infrastructure and higher security and governance risks. In short, SEZs are not equal. Some are built around logistics and ports, while others depend on long-term regional development.

Why China is Pushing Outward

China's interest in this shift is tied to changes in its own industrial economy. Beijing today faces significant overcapacity pressures in several clean-tech and manufacturing sectors. The International Energy Agency projected that global solar manufacturing capacity would exceed 1,100 GW by the end of 2024, more than double projected demand, pushing down prices and squeezing profit margins.[16] CSIS, drawing on Bloomberg NEF estimates, noted that global demand for lithium-ion and fast-charging lithium-ion batteries for electric vehicles and stationary storage was around 950 GWh in 2023, while manufacturing capacity approached 2,600 GWh. China's battery production capacity alone was roughly equivalent to total global demand that year.[17]

The electric vehicle sector shows the same outward pressure. The United States International Trade Commission reported that Chinese EV exports rose to nearly 1.6 million units worth US$ 36.7 billion in 2023.[18] These export surges reflect intense competition and surplus capacity at home, which helps explain why Chinese firms

[14] **"Industrial Cooperation/Special Economic Zones (SEZs)"**, CPEC Official Website.

[15] **"Pakistan's Special Economic Zones Rise From 7 To 44 Since 2019 Under CPEC 2.0"**, *Profit*, 17 January 2026.

[16] **"Global Renewable Capacity is Set to Grow Strongly, Driven by Solar PV"**, International Energy Agency (IEA), 7 October 2025.

[17] William Alan Reinsch, Meredith Broadbent, Thibault Denamiel and Elias Shammas, **"Friendshoring The Lithium-Ion Battery Supply Chain: Final Assembly And End Uses"**, Center for Strategic and International Studies (CSIS), 11 June 2024.

[18] David M. Hart and Mia Beams, **"What Canadian and Mexican EV Imports From China Mean for the United States"**, Council on Foreign Relations, 9 February 2026.

are increasingly looking at overseas industrial parks and third-country assembly. In a global environment of 'de-risking' from China, producing in partner countries serves multiple goals. It places manufacturing closer to end markets, reduces reliance on a China-only production base, and helps firms sustain exports by bypassing tariffs and easing political and regulatory scrutiny.

This outward industrial logic aligns with recent official language surrounding CPEC 2.0. The BoI's January 2026 briefing said the long-term plan for industrial cooperation was now being implemented through an action plan emphasising industry-led growth, export-oriented manufacturing, technology transfer and value addition, with SEZs as anchor platforms.

Why Pakistan Remains Attractive to China

Pakistan is not an ideal manufacturing destination on purely commercial terms. Its domestic market is limited, its power sector is fragile, and policy credibility remains uneven. Yet it remains attractive to China for a combination of strategic and political reasons. Pakistan offers geographic access from western China towards the Arabian Sea, a longstanding political alignment with Beijing, and scope for lower-cost assembly in sectors such as clean technology and EVs. It also offers an elite-level political consensus in favour of Chinese investment that few other countries can match.

The clearest example of Phase II's production logic is BYD's plan in Pakistan. In July 2025, BYD, in partnership with Mega Motor Company, began construction of an assembly plant near Karachi with an initial annual capacity of 25,000 units and a target start date of July–August 2026. The plant is expected to initially assemble imported parts while localising some non-electric components, with possible exports to other right-hand-drive markets, depending on commercial viability.[19]

Pakistan's solar sector offers another illustration of how quickly China-linked industrial ecosystems can deepen when price and supply conditions align. In June 2025, Pakistan's solar imports rose fivefold between 2022 and 2024 to around 16.6 GW. In early 2025, Pakistan accounted for about 12 per cent of China's solar exports, while solar reached about 25.3 per cent of Pakistan's utility-supplied electricity in the first four months of the year.[20] This suggests Chinese products can quickly dominate key sectors when local alternatives are limited.

[19] Ariba Shahid and Asif Shahzad, **"China's BYD to Assemble Evs in Pakistan From 2026"**, *Reuters*, 24 July 2025.

[20] Asad Qizilbash, **"Pakistan's Solar Surge Lifts It Into Rarefied 25% Club"**, *Reuters*, 17 June 2025.

Pakistan's Structural and Security Constraints

Yet Phase II's ambitions collide with Pakistan's structural limitations. SEZs do not succeed merely because a government designates land and offers incentives. They require macroeconomic stability, predictable taxation, efficient customs procedures, stable power supply, transport connectivity and skilled labour. As discussed above, Pakistan remains weak on several of these counts. It is therefore possible that CPEC Phase II will produce selective industrial footholds rather than broad-based export transformation.

Security is another major constraint on CPEC Phase II because industrial clustering requires more than just guarded construction sites. It involves a steady flow of engineers, technicians, managers and service providers—creating a larger and more visible Chinese footprint. Over the years, Pakistan and China have been discussing strengthened security arrangements for Chinese nationals. According to data available, in a decade, 19 Chinese personnel have been killed in Pakistan, and the majority of attacks have been claimed by the Baloch Liberation Army (BLA).[21]

In September 2025, President Xi Jinping pressed Pakistan to improve protection after repeated attacks on Chinese workers.[22] This has added pressure on Islamabad to consider changes in how foreign private security firms operate. In March 2024, media reports suggested that around 60 Chinese personnel from three Chinese private security companies—Dewe Security Frontier Service Group, China Overseas Security Group, and Huaxin Zhongshan Security Service—may have been deployed to help protect two CPEC power projects in Sindh. However, this has not been officially confirmed. If true, it would mark a shift from the earlier model in which Chinese firms relied mainly on Pakistani guards.

Why India Should Pay Attention

For India, the significance of CPEC Phase II lies not only in economic terms but also in the densification of the China–Pakistan strategic relationship. Roads and power plants create important infrastructure linkages, but industrial ecosystems create deeper forms of alignment. Pakistan will be increasingly tied to Chinese machinery, digital systems, industrial standards, supplier networks and clean-tech platforms.

[21] Namita Barthwal, **"China's Private Security Personnel in Pakistan: Implications for Regional Stability"**, Issue Brief, Manohar Parrikar Institute for Defence Studies and Analyses (MP-IDSA), 9 April 2025.

[22] **"China's Xi Presses Pakistan to Improve Security for Chinese Workers"**, *Reuters*, 2 September 2025.

Even if many announced SEZs remain underdeveloped, a smaller number of viable zones in sectors such as logistics, EV assembly, solar, mining support, or digital infrastructure could still generate a durable Chinese influence.

This has five direct implications for India. First, CPEC is no longer only about infrastructure finance; it is moving towards deeper industrial integration that could bind Pakistan more closely to China. Second, this can expand China's influence over Pakistan's economic choices, industrial development and technology base. Third, CPEC projects presented as commercial may gain strategic value over time as industrial parks, logistics systems and digital networks grow around them. Fourth, some SEZs and technology-linked projects could gradually acquire dual-use significance, making them more strategically important for Beijing to protect. India's concern is sharpened by the fact that parts of CPEC pass through Pakistan-occupied territory in Jammu and Kashmir. Fifth, these industrial and logistics ecosystems could also support a stronger long-term Chinese maritime presence in the Indian Ocean Region, especially around ports, repair networks, digital infrastructure and transport nodes.

Conclusion

CPEC Phase II should therefore be understood less as a guaranteed industrial breakthrough than as a strategic attempt to embed Chinese firms, standards and supply networks more deeply into Pakistan's economy. Its success is far from assured. Pakistan's weak power finances, institutional bottlenecks, uneven zone readiness, limited market size and persistent security threats all constrain the project. But the strategic direction is clear. The real question is not whether all 44 approved SEZs will become functional. It is whether a smaller number of viable zones can create durable Chinese industrial footholds in Pakistan. If they do, CPEC will have moved beyond mere corridor into the realm of long-term structural influence.

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