

# China's economic engagement in the Middle East and North Africa

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>> Although political upheavals since 2011 have prompted Beijing to review its posture in the Middle East and North Africa (MENA), China had been ramping up its presence in the region since well before the Arab Spring. As Beijing implemented its 'going global' strategy as a recipe for economic growth, China became more commercially and diplomatically engaged to advance its interests in the region. Recent developments such as rising Chinese investments in the Iraqi oil sector and broader efforts to sell more Chinese goods and services to the MENA region have underscored China's increasing presence in the vast area stretching from Morocco to the Gulf. In turn, with China's stature in the region growing, some MENA countries are responding by 'looking East' for an alternative partner. The increased Chinese footprint gives smaller regional powers an additional partner to their traditional ties with the United States and Europe.

## THE ENERGY FACTOR

Since the 2003 US-Iraq war, China has been stepping up its profile in the MENA region. With domestic economic expansion as its priority, China's thirst for energy has guided much of the country's Middle East policy, and Beijing seeks to maintain positive relations with all countries in the region. As the Chinese economy grew, its oil imports also surged from \$664 million in 1980 to \$235.75 billion in 2011.

## HIGHLIGHTS

- China is the largest importer of oil from the Gulf region and OPEC's share of China's oil imports is rising fast.
- The MENA region is a growth market for more affordable Chinese products and engineering services.
- The region's governments see a more influential China as a source of both growth and political leverage vis-à-vis the United States and Europe.

»»»»» China is today the world's largest oil importer. According to a 2013 report by Wood Mackenzie, a consultancy firm, China will spend about \$500 billion on crude oil imports by 2020, while the share of the Organization of the Petroleum Exporting Countries (OPEC) in Chinese imports will rise from 52 per cent in 2005 to 66 per cent in 2020. China's crude oil imports from OPEC overtook those of the US for the first time in 2013.

China uses its large foreign currency reserves to acquire equity stakes in energy companies, with Chinese national oil companies (NOCs) purchasing \$18 billion in overseas assets in 2011, including investments in the MENA region. In contrast, as China imports more oil and gas from the MENA region, the United States is becoming more energy-independent due to alternative means of oil and gas exploitation. Meanwhile, as EU countries decreased their crude oil imports from the MENA region from 21.59 per cent in 2005 to 19.47 per cent of the total in 2011, they increased their imports from former Soviet republics from 38.40 per cent to 43.43 per cent over the same timeframe. All this sets China on the path to becoming an even more significant economic partner for the Middle East.

Ten years after the 2003 US invasion, China has emerged as an influential economic player in Iraq, for example. Robust Chinese investments in Iraq's energy sector are expanding Beijing's presence in the country, with Baghdad gaining an important partner in addition to American and European investments. As sectarian violence compelled Western firms to abandon southern Iraq in favour of oil sources in Iraqi Kurdistan, Chinese state oil companies stepped in to take advantage of the region's resources. With state backing, Chinese firms are more risk-tolerant and have collectively made China the biggest single player in Iraq's energy industry. The New York Times reported that China presently buys nearly half of Iraq's 1.5 million barrel daily oil production. China's NOCs now own major stakes in the al-Ahdad, Halfaya and Rumaila oil

fields. To foster closer relations with Baghdad, Beijing forgave about 80 per cent of Iraq's \$8.5 billion debt to China in 2010 and has signed multibillion-dollar trade deals, including in the heavy industry, government, tourism and transportation sectors.

### **A GROWING MARKET FOR CHINA'S TRADE AND INVESTMENT**

Aside from importing oil and gas from the Middle East, China also sees the region as a growth market for its products. Focused on affordable consumer goods and services, such as construction and engineering, Chinese exports to the MENA region have been modest but steadily increased from 2.8 per cent in 1994 to 5.8 per cent in 2010 as a total percentage of Chinese exports. According to Bo Zhiyue, a China expert at the National University of Singapore, taken as a single economy, the Middle East would rank as China's fourth or fifth largest trading partner.

Although Iran's economic relationship with China has been historically based on the oil and gas trade, international sanctions and China's increased economic significance have altered these countries' trade relations. While often inferior in quality, cheaper Chinese goods are now more accessible to Iranian consumers than the country's traditional reliance on European products. Previously, Germany, Italy and Greece were Iran's top trading partners. Presently, China is the top destination for Iranian exports while Chinese imports in Iran are second only to those from the United Arab Emirates (UAE). According to a Massachusetts Institute of Technology (MIT) index, oil makes up most of Iranian exports to China while Iran imports mostly automobiles, industrial equipment and consumer goods from China. Increasingly, Chinese firms are winning contracts for key infrastructure projects, such as Tehran's metro system and the Sadr expressway expansion project. Yet even as trade expands between the two countries, both face challenges: Beijing must

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carefully navigate international sanctions on Iran even as it uses Chinese goods to barter for Iranian oil, while Iran's dependence on trade with China leaves the Iranian economy highly undiversified and threatens its non-oil sectors.

Egypt's large population provides a consumer market for inexpensive Chinese products and the country's strategic assets can also further China's interests in the region. As Chinese exports to Egypt surpassed those from the United States in 2011, Egypt in return can offer China economic and geo-political influence in Africa and the Middle East. As a traditionally influential player in the Arab world, a closer relationship with Egypt could buy China political goodwill in the region, but may also facilitate practical benefits such as expedited access to the Suez Canal for Chinese commercial vessels and warships. By developing a working partnership with the Morsi government, Chinese efforts initially produced

increased bilateral trade with Egypt.

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In Francophone North Africa, Algeria stands out as the subject of Chinese attention. Although China mostly relies on domestic natural gas and liquid natural

gas (LNG) imports from the Persian Gulf and Asia, it is interested in the Algerian consumer market. Given Algerian banks' ability to self-finance development projects, China sees the country as a lucrative market for Chinese engineering expertise. After France and Italy, China is Algeria's third largest source of imports. The Chinese economic footprint in Algeria is most pronounced in the infrastructure development sector. For example, Chinese firms built a large chunk of the 1,216 km East-West highway to link Algeria's divergent regions.

While states such as Saudi Arabia enjoy a favourable trade balance with China due to their energy exports, trade imbalances between MENA

states and China continue to be a sensitive political subject. In this respect, the region's manufacturing sector has struggled to compete with Chinese imports. Cheap Chinese products have increased MENA consumers' purchasing power but China's manufacturing power is also threatening the survival of local industries, such as textile or the marble sectors. Chinese businesses' practice of bringing Chinese labour to work on infrastructure projects also contributes little to alleviating local unemployment problems.

As cited by a US National Defence University (NDU) report, in 2009 violence broke out between Algerians and Chinese migrant workers, and Iraqis who failed to benefit from China's oil investments have threatened Chinese oil workers in the Wasit Province. Dating from 2010, Egyptian officials under Mubarak have deplored the trade imbalance between the nations. According to Chinese statistics, trade deficits between the two countries rose to \$5.8 billion in favour of China in 2011, and Egypt is keen to develop a more balanced commercial relationship in order to lift itself out of its current economic crisis. Morocco's trade deficit with China in 2012 was also very large, with the North African country buying \$3.13 billion in Chinese goods and services while only exporting \$558 million to China. For Iran, with Chinese consumer products flooding the local market and sanctions denying the country access to international capital, Iranian manufacturers are finding it difficult to compete. With cheap Chinese products and the outsourcing of major construction projects to Chinese companies driving many local firms out of business, Teheran may reassess its shifting economic relations with China.

### POLITICAL IMPLICATIONS

MENA regimes benefit from enhanced relations with China. While the United States and EU members seek domestic political reforms through foreign aid, Beijing focuses on trade and demands no quid pro quo in exchange for



»»»» its investments. For resource-based economies such as Saudi Arabia and other members of the Gulf Cooperation Council, pivoting east has long been a strategy to diversify their economic and political partners. Non-rentier states undergoing political transitions also see China as a source of both investment and political leverage vis-à-vis the United States. Through informal alliances and diplomatic hedging, smaller nations in the Middle East could maximise their relationship with extra-regional powers.

With a number of MENA countries undergoing political transitions since 2011, the Chinese political elite has debated how best to engage the region's emerging political actors. For most countries in the region, such as Saudi Arabia, Iran and Algeria, Beijing has maintained its working partnerships with the local political establishment. While abstaining on UN Resolution 1973 which paved the way to military intervention in Libya in 2011, Beijing continued to stress its policy of mutual non-interference and preference to solve the Libyan civil war and the ongoing conflict in Syria through negotiations. But in some of the MENA countries undergoing political transitions, Chinese foreign policy officials actively engaged the region's then rising Islamist political currents, such as Egypt's Muslim Brotherhood (MB) and Tunisia's Ennahda, in order to establish relations with the region's rising political forces and to mitigate the Islamic world's criticism of Beijing's crackdown on China's restive Uighur population.

In particular, deposed Egyptian President Mohamed Morsi's decision to make Beijing his first foreign trip outside of the Middle East and Africa reflected China's growing importance to the MENA region. Chinese officials held private visits with Egypt's Muslim Brotherhood (MB) even before the 2011-2012 elections; in turn, during its political campaigns the MB publicised its working relationship with Chinese officials to demonstrate its foreign policy competence. As suggested by Wang Suolao, a Middle East expert at the Centre for International and Strategic Studies at Peking University, though Egypt

maintains its special ties to the US military establishment, Morsi's outreach to China was meant to reduce Egypt's traditional reliance on the West. However, while Morsi's overture to China produced Chinese investment to build a power plant, a water desalination plant and a high speed rail line connecting Cairo and Alexandria, his June 2013 deposition put relations on hold. While commercial diversification is likely to remain a priority for the new regime in Egypt, it remains to be seen how actively that will be pursued, including with China.

## **CONCLUSION**

China's history of involvement in the MENA region has been solidly anchored in the principle of mutual non-interference and a preference for commercial relations above political and military initiatives. To sustain its need for oil and gas, China seeks friendly relations with MENA regimes, and is now one of the largest investors in the region's oil and gas sector. However, over the past decade, China's economic involvement in the Middle East and North Africa has evolved from its dependence on the energy trade to much broader commercial engagement, including trade in consumer goods, automobiles and services such as engineering, construction and infrastructure development. China is now the largest trade partner for some of the region's most influential economies, including Saudi Arabia and Iran. In Iraq, although the United States remains the country's top economic partner, Chinese investments in the oil and gas sector now account for a significant segment of the country's economic output.

Notwithstanding China's preference for a low-key political profile in the MENA region, political upheavals during the past decade have given Beijing the opportunity to enlarge the Chinese presence in the region. From working through multilateral fora to economic diplomacy, China's newfound activism,

combined with regional political actors' desire to diversify their economic and political partners, is beginning to foster a new political dynamic in the Middle East. Although the United States and Europe continue to be the most significant extra-regional actors in the region, MENA regimes increasingly seek a higher level of Chinese involvement in the Middle East and North Africa.

In Iraq, Beijing's engagement with the al-Maliki government is paying off by injecting much-needed foreign investment into the Iraqi economy while providing the Chinese economy with additional sources of oil. While China, the United States and the EU have often disagreed on punitive measures targeting Tehran, Beijing continues to play a key role in the P5+1 nuclear negotiations with Iran even as China continues to be Iran's largest trade partner. Although the Egyptian military deposed President Morsi in June 2013, Beijing's brief rapport with the former president demonstrated Egypt's potential not only as an influential diplomatic partner in the Middle East, but also as an attractive market for competitively priced Chinese consumer goods.

For the United States and Europe, a strengthened Chinese role in the Middle East presents both challenges and opportunities. China greatly values its economic and political partnership with the United States and the EU, and is concerned with preserving political stability and fostering its economic ties in the Middle East. The question is whether China's approach to stability in the region will prove compatible with US and European policies and priorities, or will challenge them.

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