

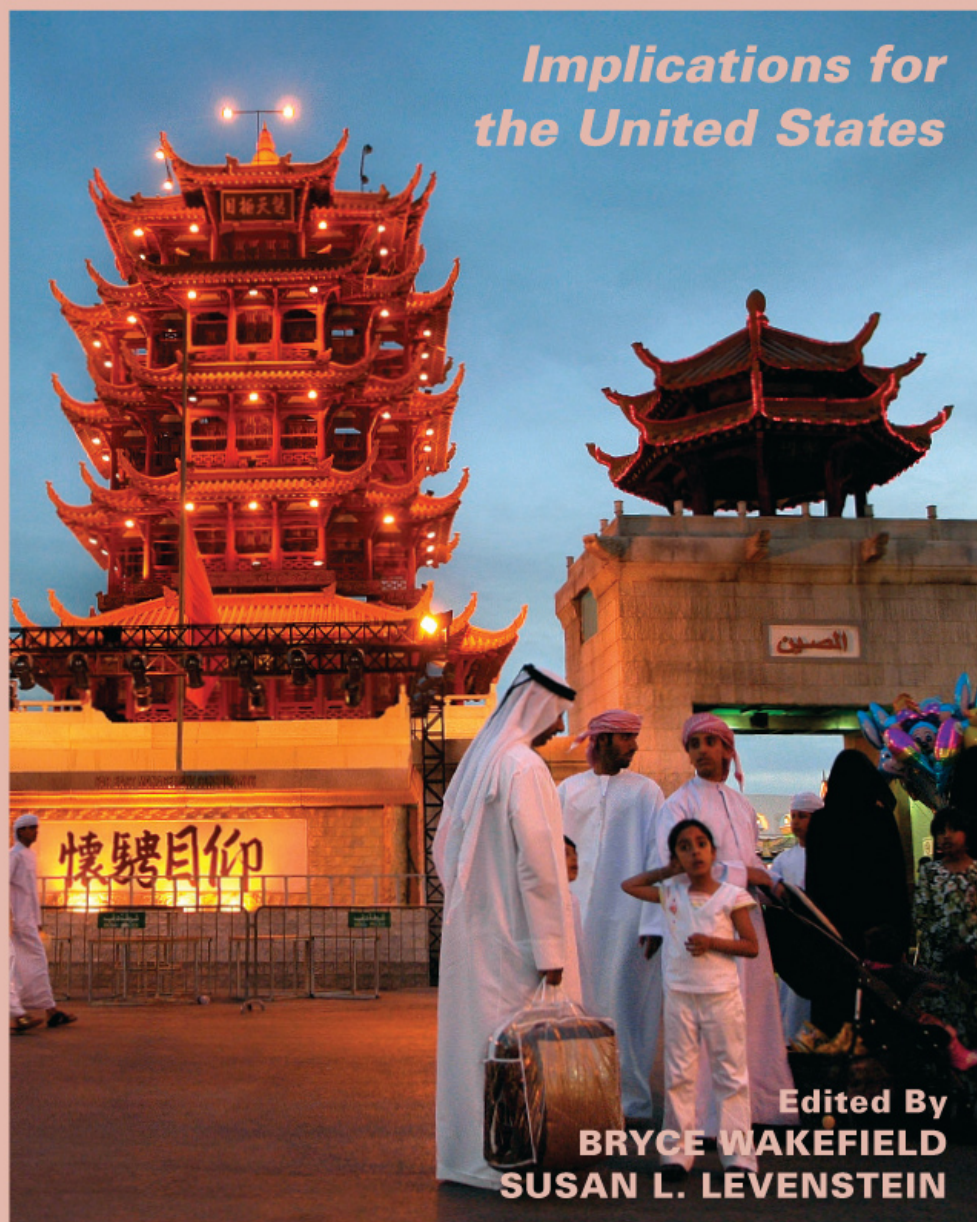


Woodrow Wilson
International
Center
for Scholars

*A collaboration between the Asia Program, the Kissinger Institute
on China and the United States, and the Middle East Program*

CHINA and the PERSIAN GULF

*Implications for
the United States*



Edited By
BRYCE WAKEFIELD
SUSAN L. LEVENSTEIN

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ESSAYS BY

Wu Bingbing
Jon B. Alterman
Emile Hokayem
Afshin Molavi
Jean-François Seznec
Erica Downs

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www.wilsoncenter.org



Available from :

Asia Program

Woodrow Wilson International Center for Scholars

One Woodrow Wilson Plaza

1300 Pennsylvania Avenue NW

Washington, DC 20004-3027

www.wilsoncenter.org

ISBN 1-933549-64-5

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ACKNOWLEDGMENTS

This volume of essays is the result of a collaboration among the Asia Program, the Kissinger Institute on China and the United States, and the Middle East Program of the Woodrow Wilson International Center for Scholars. The editors of this report are deeply indebted to Haleh Esfandiari, Robert Hathaway, Kendra Heideman, Sandy Pho, J. Stapleton Roy, Douglas Spelman, and Mona Youssef. The editors also wish to thank the individuals whose essays appear within these pages. This book is dedicated to Azi Barranca, Adam Kugelman, Henry Levenstein, and Alex Wakefield.

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INTRODUCTION

Bryce Wakefield

China's rise is shaping up to be the most salient development of international politics and economics in the early 21st century, and Beijing is increasingly searching for stable sources of energy to power its ballooning economy. This has meant that China's relations with resource-rich Persian Gulf states have become more intensive even as Beijing has become more pragmatic in its approach to the region. Whereas once China viewed events in the Gulf region through the lens of its own revolutionary ideology, its relations with Middle Eastern nations are now driven more by energy concerns. Chinese state-owned oil companies are now aggressively bidding for contracts in the Gulf, and there is a clear Chinese presence in regional commerce.

For many Gulf nations then, Beijing's interest in the region clearly offers new and expanding business opportunities in the energy sector. However, energy commerce is not the only aspect of invigorated relations between China and Persian Gulf nations, especially Saudi Arabia and Iraq. China's rise as an export power has also presented Middle Eastern merchants with the opportunity to travel to China in search of cheap goods, while the Persian Gulf is an increasingly important source of capital for Chinese financial institutions.

China's pragmatism has also meant an emphasis on relations with new partners in the region at the expense of older ties. After 2001, China saw Iran as an attractive partner, due to its geographical proximity and potential to supply large volumes of oil. However, Iran's low production capacity has disappointed Beijing, which has sought to create new ties in the region.

What does the United States make of China's approach to the Persian Gulf? The Gulf has long been an area of interest to Washington, and highly competitive new players in oil markets are bound to cause its policymakers

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concern. With the United States acting as a security guarantor in the region, Beijing's reluctance to take a stance on political issues there means that Washington is increasingly irritated by what it sees as China's free ride on American security. Worse, it is not altogether clear that Beijing views the U.S. presence as a stabilizing force in the Gulf, a perception gap that may be a source of friction between the two great powers in years to come.

On July 12, 2010, the Middle East Program, the Asia Program, and the Kissinger Institute on China and the United States at the Woodrow Wilson International Center for Scholars co-hosted a two-panel conference to consider China's role in the Persian Gulf, changing views from within the Gulf on China's expanded presence in the region, and what this presence means for the United States. The essays in this volume were originally papers presented at that conference.

CHINA'S MOVE TOWARD PRAGMATISM IN GULF POLITICS: ASSET, LIABILITY, OR INEVITABILITY?

In the first contribution in this volume, **Wu Bingbing** of Peking University surveys China's historical relations with the Gulf, noting that in recent years, ideology has gradually been abandoned in pursuit of economic and trade, energy, and non-traditional security interests. During the late 1950s and 1960s, China supported local movements resisting the monarchies of the Gulf region, viewing such movements through the lens of its own revolutionary history. Beijing was particularly supportive of Iraq after that nation's 1958 revolution, and saw its leader, Abdul Karim Kassem, as a new type of people's revolutionary who recognized communist political forces in his country.

Nevertheless, the Sino-Soviet split from 1965, invasion of Czechoslovakia by Warsaw Pact nations in 1968, improving relations between China and the United States from the early 1970s, and the United Kingdom's 1971 decision to pull its troops out of the Gulf all prompted Gulf monarchies such as Kuwait and Iran to see a Chinese presence as a possible check on Soviet expansionism in the region. From the end of the 1960s, moreover, it was clear that relations between Baghdad and Beijing had not lived up to their earlier promise, and China began to adopt a softer approach toward monarchies in the Gulf. By the late 1970s, for example, China was less

enthusiastic about opposing crackdowns in the region on anti-monarchist forces in Oman.

Wu explains that with the onset of the Iranian Revolution in 1979 and the Iran-Iraq War the following year, the main source of political tension in the region shifted from ideological conflict between Iraq and the Gulf monarchies to either an ethnic battle between Arabs and Persians (from Iraq's perspective) or (from Iran's perspective) a religious struggle against anti-Islamic regimes. At the same time, political and economic reforms in China meant that Beijing was willing to adopt a more even-handed role in the Gulf, while also taking care not to challenge the United States on its core interests. However, the international condemnation of the Saddam Hussein regime after Iraq invaded Kuwait in 1990, coupled with increasing Chinese oil demand due to economic growth, meant that during the subsequent decade, China increasingly saw Iran as its most important partner in the region.

Given Tehran's nuclear provocations, China's support of Iran is now of obvious concern to the United States, but Washington also finds other aspects of China's Gulf strategy problematic. A greater Chinese presence in the Middle East comprises the convergence of two key issues for U.S. strategic planners: China's rise in the international arena, and American energy security, an issue that Washington has taken seriously since the oil shocks of the 1970s. Viewed from the United States, Chinese moves in the Persian Gulf therefore come with their own special set of challenges.

Rather than seeing China's growing role in the Persian Gulf as a source of competition to the United States, however, **Jon B. Alterman** of the Center for Strategic and International Studies believes that China and the United States may well be compelled to cooperate by strategic forces beyond their control. Reviewing the strategic balance in the region, Alterman sees a triangular relationship between the United States, China, and the Middle East as a whole. American military planners are clearly wary of growing Chinese power and influence, not only in the Gulf but also out into the Pacific, although trading relations between the two nations remain strong. The United States, meanwhile, maintains positive relationships with most Middle Eastern nations, many of which are reliant on the protection of the American military. However, the United States is not the principal oil export market for any oil-producing Gulf country, and the rapidly expanding relationships for China in the region mean

that, from an American perspective at least, China benefits from U.S. security guarantees.

This is problematic for China, which has little or no desire to contribute to regional security efforts—indeed, Beijing views previous U.S. military operations in the Gulf, particularly the 2003 American-led invasion of Iraq, as destabilizing. Nevertheless, Alterman believes that the only way to think of the relationships among the United States, China, and the Gulf States is as an “inescapable triangle.” Each party has significant leverage that can be used on the other two if they attempt to reframe relationships in the region. Interdependence means that the three sides of the triangle must cooperate. Therefore, Alterman interprets such moves as the dispatch of Chinese peacekeepers to Lebanon as a positive sign of growing Chinese recognition of the need for international cooperation on security issues. Nevertheless, he states that “there is something inherently unstable about a region that relies on the West for security and the East for prosperity.”

GROWING MUTUAL TIES

Despite Alterman’s notion of an equally balanced triangle, increasing ties between China and the Middle East are evident almost everywhere throughout the region. Beijing’s pragmatism and a general policy of detachment from political issues have also influenced Persian Gulf views of China. According to **Emile Hokayem** of the Institute for International Security Studies—Middle East in Bahrain, China has few modern historical connections to the Gulf and is seen by many Gulf states as an honest broker, free of the political baggage of colonization and historical military adventurism in the region. This has allowed Beijing to play a larger regional role, meaning that the Gulf as a whole is already China’s largest oil provider. By 2020, annual trade between China and the Gulf will top \$350 billion, while trade between China and the United Arab Emirates alone will likely reach \$100 billion per year. A free trade agreement with China is also a priority for the Gulf Cooperation Council, and China is bidding for major contracts throughout the region. China’s less than demanding labor, environmental, and human rights standards often make it even more attractive as a partner to leaders in the Gulf, who can be assured that Beijing, unlike Washington, will not raise these issues in negotiations.

As a non-Western but growing nation, moreover, China might also serve as a model of development for Gulf nations.

Indeed, according to **Afshin Molavi** of the New America Foundation, oil exports may be the focus of most strategic planners in Washington, but in 2009, the same year that it became the largest importer of oil from the Gulf, China quietly passed the United States as the largest single exporter to the region as well. Trade, meanwhile, entails greater two-way exchange. For example, there are now more Middle Eastern visitors to Yiwu, a city in China that houses tens of thousands of retailers, than there are to the entire United States. Cross-border investment from the Middle East in Chinese financial institutions also represents a new mode of exchange. The importance that China places on the Middle East is evidently mutual.

Molavi sees this increased interaction as natural, given the geographical proximity of China and the Middle East, and representing nothing more than a coming together of Asia as a whole, with “growing links between ‘West Asia’ (i.e., the Middle East) and East Asia.” He also sees “South Asia,” represented by India, where development is also driving energy consumption, as part of this mix. Indeed, India has long been a presence in the Middle East. Citing the combined gross domestic product of China and India at \$6.3 trillion, a combined population of 2.5 billion, and a combined average growth of 7.5 percent, Molavi notes that it made perfect sense for Saudi King Abdullah bin Abdulaziz to visit Beijing and New Delhi on his first trip overseas after ascending to the throne in 2005.

In fact, since 2006 Asia as a whole has been the most important trade region for the Middle East, importing 11 million barrels of oil per day, of which China takes 6 million barrels each day. China and India will consume 26 percent of Saudi oil by 2030, compared to 17 percent for the United States. Molavi sees China as an “energy panda” that needs a secure and constant flow of energy resources, just as a panda needs to constantly eat in order to survive. China and, to a lesser extent, India will continue to consume Gulf oil as their economies grow, a point not lost on officials in the Gulf, who view reliable and sustainable demand for oil, the lifeblood of their region’s economy, as a security issue.

SHIFTING FOCUS

Part of ensuring a reliable oil supply is finding stable trading partners. As Wu notes in his essay, it has become ever clearer since 2001 that China prefers an energy strategy in the Persian Gulf that is heavily focused on Iran and Saudi Arabia as major suppliers of oil. According to Wu, American security guarantees to Riyadh make Saudi Arabia a relatively secure source of energy for China, whereas international sanctions on Tehran have allowed China to move into untapped markets in Iran. Iran is also a convenient supplier because of its proximity to China. However, antagonism between Iran and the United States, and a Chinese desire for cordial relations with Washington, have meant that Beijing has been cautious about its relations with Tehran. Wu believes that the extent to which China can maneuver between the pro-American regime in Saudi Arabia and the anti-American regime in Iran is a question that will test the pragmatism of China's Gulf policy.

Indeed, in his contribution, Hokayem also suggests that most Arab states are quietly concerned about the threat that Iran's regional ambitions and its nuclear program pose to regional stability. China's preference to avoid using its leverage over Iran, partly due to a desire to keep its options open should there be problems with other relationships in the region or other concerns related to stability of supply, has meant that Beijing has frustrated Gulf nations' support for international sanctions against Iran. Hokayem believes that Gulf nations could encourage a reluctant China to apply more pressure on Iran by offering supply and price guarantees to Chinese oil companies. Such guarantees would mean that Iran could not use its current oil sales to China as diplomatic leverage and Beijing would feel less concerned about supporting international sanctions.

In the course of exploring China's relationships in the Gulf in their two separate essays, **Jean-François Seznec** of Georgetown University and **Erica Downs** of the Brookings Institution, consider the dynamics of China's current relations with Saudi Arabia and Iran in greater detail. China's relations with Iran have caused notable controversy even beyond the United States and Arab nations in the Gulf. As Seznec notes, human rights campaigners, Iranian émigrés, and Israel's Likud Party have all castigated China for propping up the oppressive regime in Tehran. However, appearances are deceiving: China's apparently extensive relations with

Iran are based on “talk with little action.” China’s willingness to keep its options open in Iran masks deeper shifts in its profile of energy imports from the Middle East.

These shifts are reflected in the decreasing trade flows between Iran and China, with total bilateral trade amounting to \$21 billion per year, including the \$10 billion from Iran’s oil trade. By contrast, Beijing has increasingly favored relations with Saudi Arabia and its oil company, Saudi Aramco, which has a reputation for stability, over other regional actors. China’s annual trade with Saudi Arabia totals \$60 billion, which includes 20 percent of China’s oil supply. As Erica Downs notes, increased Chinese demand is not the only driver of Saudi exports. Calls from Washington for the Saudis to reform their regime have strained relations with Riyadh and encouraged it to diversify its export profile. Meanwhile, as Sez nec explains, Saudi Arabia uses its inexpensive indigenous supply of natural gas—a product that China can procure cheaply elsewhere—to make quality chemicals for use in China’s burgeoning manufacturing sector. China and Saudi Arabia are increasingly interdependent.

While Saudi Arabia may be a stable source for the time being, Downs’s analysis shows that China is also looking to take advantage of Iraq’s desire to increase production. The China National Petroleum Corporation (CNPC) was one of only two oil companies to successfully bid for contracts in Iraq’s first oil-field auction in June 2009. CNPC has accepted low remuneration rates for extracting oil in Iraq, but agreed to expand operations at the giant Rumaila oil field to increase supply and therefore gross remuneration. CNPC’s activities, along with those of other Chinese oil companies, have made China one of the largest oil beneficiaries of the Iraq War. Indeed, Beijing envisions Iraq as key to its strategy of increasing production by Chinese companies from 1.5 million barrels per day of oil equivalent in 2009 to 4 million barrels per day in 2020.

The deep links forged between Riyadh and Beijing as well as the possible reemergence of Iraq as one of the world’s largest oil exporters and one of China’s most important partners means, in Sez nec’s words, that China can afford to “amuse Tehran” by offering deals to which Beijing need not fully commit. China wants to be “Iran’s sole patron, but without committing full support” in order to avoid upsetting other regional partners and the United States. China will maintain its relationship with Iran to ensure supply from that country, but Saudi Arabia is increasingly where the action

is in China's Middle East energy strategy. This represents a major problem for Iran, given that it desperately needs Chinese investment to fund its natural gas production projects.

Indeed, focusing particularly on China's relations with Iran, Downs notes that the prospects of cooperation between the two nations do not look good. Unlike in Saudi Arabia and Iraq, where Chinese investment is conspicuous, Beijing has learned that Iran is a "hard place to do business." Terms offered to foreign investors in Iran are difficult to negotiate and not particularly attractive. Meanwhile, international pressure on China to comply with nuclear-related sanctions against Iran has complicated the bilateral relationship between Beijing and Tehran. Downs believes that actual Chinese investment in the exploration and production of Iranian petroleum is barely a fraction of the \$80-100 billion that is often reported. This higher figure includes non-binding arrangements, and thus cannot be interpreted as a true measure of the investment relationship.

A focus on shifting national relationships, especially the manner in which China views Saudi Arabia and Iran, is therefore key to understanding China's increasing role in the Persian Gulf. It is clear that Beijing now views the Gulf according to the rules of old-fashioned pragmatic statecraft and commercial interest. This is a relatively new role for China, which two generations ago focused more on non-traditional means of diplomacy by encouraging popular revolution against Gulf monarchies. Beijing is now attempting to hedge with Iran, and has tried not to intervene politically elsewhere in the Gulf, while the United States maintains a heavy military commitment there. The sustainability of these arrangements is open to question. However it is certain that China will be a major, if silent when possible, player in the region going forward.

STRATEGY AND POLITICS IN THE GULF AS SEEN FROM CHINA

Wu Bingbing

China's core national interests in the Gulf region currently include geopolitical interests, economic and trade interests, energy interests, and non-traditional security interests. Its geopolitical interests consist of four dimensions: to refuse any single power's unilateral control of the whole region, to prevent the emergence of any anti-Chinese regime in the region, to oppose any formal support of Taiwanese independence forces or other separatist forces in China by Gulf countries' governments, and to pursue possible and potential support from the Gulf region for China's foreign strategy. China's core national interests in the Gulf have been in continuous evolution. Ideological interests have been abandoned and economic and trade interests, energy interests, and non-traditional security interests have emerged gradually during the last three decades.

The combination of China's foreign strategy, core national interests in the Gulf and the Gulf region's strategic structure all determine China's Persian Gulf policy, which has witnessed six phases since the late 1950s: (1) a focus on Iraq (1958-1967); (2) a focus on revolutionary movements in the Gulf (1967-1971); (3) opposition to Soviet expansionism (1971-1979); (4) a focus on Iran and Iraq (1979-1990); (5) a focus on Iran (1990-2001); and (6) a focus on Saudi Arabia and Iran (2001 till now).

CHINA AND THE GULF: 1958-1979

China's Gulf policy is subordinate to its overall foreign strategy. Before China embarked on reforms to open up its economy in 1979, China's Gulf policy shifted from an ideological orientation to pragmatism. Before

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that, however, ideology and geopolitical interest both played a role in Beijing's calculations.

China began to make progress in developing relations with Middle Eastern countries after the 1955 Bandung Conference of Asian and African countries, and established diplomatic relations with Arab countries mainly in the Mediterranean region. Gulf countries such as Iran, Iraq, and Saudi Arabia sent delegations to the conference, but as conservative monarchies they were not ready to recognize the People's Republic of China, especially when both Iran and Iraq were still members of Baghdad Pact Organization, a mutual security pact established in 1955 to counter Soviet influence in the region. However, China began to send delegations to Saudi Arabia for pilgrimage after the conference.

After the July 1958 revolution in Iraq, the country's new leader, Abdul Karim Kassem, decided to withdraw from the Baghdad Pact Organization and recognized the role of the Iraqi Communist Party in international affairs. China considered Kassem a new revolutionary leader in the Arab world in the mold of Egypt's Gamal Abdul Nasser. In August 1958, only one month after the revolution, China and Iraq established diplomatic relations, which provided China a chance to extend its influence to the Gulf region.

In 1959 a rift between China and Egypt became obvious, because Nasser chose to stand with the Soviet Union in Sino-Soviet disputes, and criticized China over its treatment of Tibet and Sino-Indian relations.¹ As a result, Iraq was considered by China not only as its focus in the Gulf region, but also as its pillar in the Arab world. Although China supported Arab countries in the 1967 Middle East War, it "lacked material means to influence the war in the remote Middle East"² because it was in the process of its own Cultural Revolution. Arab countries including Iraq gravitated towards the Soviet Union instead of China, and Sino-Iraqi relations turned cold.

In June 1965 the Dhofar Liberation Front began to launch military attacks against the Oman government, and in June 1967 the Front's delegation to Beijing successfully gained China's support. Its name was changed to "the Popular Front for the Liberation of the Occupied Arabian Gulf" in 1968. China's support of the revolutionary movement in Oman was a natural result of its foreign strategy shift. After the Sino-Soviet split in 1965, Beijing formulated a strategy of "anti-imperialism and anti-revisionism at the same time," where it was hostile towards both the United States and the

Soviet Union. When the Cultural Revolution was launched in 1966, China adopted an extremely leftist foreign policy focused on Maoist ideology and anti-Soviet positions as the standards by which to judge relations with other countries.³ This policy complicated China's foreign relations, and was modified in 1968. The Soviet invasion of Czechoslovakia in 1968 and Sino-Soviet border conflict in 1969 forced China to reconsider its strategy of hostility towards both Cold War superpowers, and Beijing sought to improve its relations with the United States. Sino-Gulf relations also began to change, and China began to reduce its support to Oman's revolutionary movement gradually from 1971.

China exploded its first atomic bomb on October 16, 1964, and became a nuclear weapon state. With both Sino-Soviet and Sino-Iraqi relations frosty since the mid to late-1960s, China attempted to develop its relations with the monarchies in the Gulf. When Great Britain withdrew its troops from the Gulf in 1971, it left a vacancy which China and the Gulf monarchies were all afraid that the Soviet Union would fill. The same period marked an improvement in Sino-U.S. relations. Against this background, China ceased all support for the revolutionary movement in Oman, which was a crucial step in removing the main obstacle to better relations between China and the Gulf monarchies. Kuwait and Iran established diplomatic relations with China in March and August 1971 successively.

Beijing resumed its seat in the United Nations in October 1971, and U.S. President Richard Nixon visited China in 1972, so a Sino-U.S. alliance against the Soviet Union emerged as a foreign strategy in China. Chairman Mao set forth the Three Worlds Theory in 1974, which, regarding the Soviet Union as another hegemonic superpower besides the United States, sought to "treat the Soviet and U.S. hegemonism differently," that is, official doctrine was to oppose the hegemony of both superpowers, but to concentrate more on that of the Soviet Union.⁴

Kuwait intended to benefit from its relations with China in order to balance the Soviet threat on the global level and the Iraqi threat on the regional level, but could find very few common interests with China. Such a situation led to comparatively cold relations between China and both Kuwait and Iran. Nevertheless, China did manage to establish diplomatic relations with these two Gulf monarchies, an act which symbolized better relations than during the first years of China's Cultural Revolution. Iran sent troops to Oman to crack down on the anti-government forces in

Dhofar in 1973, and met no objection from China. Indeed, Oman announced its success against the anti-government revolutionary forces, but when a pro-Soviet regime came into power in South Yemen in 1978, Oman decided to establish diplomatic relations with China to balance the Soviet influence.

Iraq and the Soviet Union signed the Treaty of Friendship and Cooperation in April 1972, to develop closer relations. However, the oil price shock in 1973 brought Iraq and the West closer together, and the Algiers Agreement, signed by Iraq and Iran in 1975, resulted in détente between Iraq and Iran.⁵ Closer Sino-Iraqi relations were developing at the expense of the Iraq-Soviet relations.

In the mid and late 1970s, China thus kept friendly relations with all four Gulf countries it came to recognize, and benefitted from fears in the Gulf about Soviet expansionism.

FOCUSING ON IRAN AND IRAQ: 1979-2001

From the implementation of more liberal reforms in China from 1979 to the September 11, 2001 attacks on the United States, China's focus in the Gulf shifted from Iraq to Iran. The Islamic Revolution broke out in Iran in 1979, which changed the situation in the Gulf fundamentally. The Iran-Iraq War, which began in 1980, meant that ideological battles between Iraq and the Gulf monarchies were no longer the main source of antagonism in the region. According to Iraq's discourse, ethnic conflict between Persians in Iran and Arabs in seven Arab Gulf states was the new source of conflict, whereas Iran propounded religious violence against anti-Islamic regimes.

Meanwhile, China's economic, trade, and energy interests became more and more prominent in the Gulf region, while ideological interests were abandoned. In the twelfth National Congress of the Communist Party of China in 1982, China announced that socialist modernization would be the main goal of the country and peace and development would be considered as the two major themes in its approach to the world. China actually "abandoned the theory of international class struggle and the strategy of the international united front."⁶ Its grand strategy formally maintained that China would never pursue hegemony in its international relations and would respect the choices of other countries made by their own people,

assuming foreign policy positions according to the fundamental interests of Chinese people and the people all around the world.⁷

China took a pragmatic position during the Iran-Iraq War, maintaining strict neutrality and persuading the two sides to negotiate on the one hand, and providing weapons to both sides on the other.⁸ According to the data of the Stockholm International Peace Research Institute (SIPRI), China began to sell weapons to Iran in 1981, and the value of Chinese weapons accounted for 41 percent of the total value of Iran's arms trade from 1980 to 1988.⁹ China began selling arms to Iraq in 1982, and exported weapons that constituted 17 percent of the total value of the arms trade to Iraq during the period between 1980 and 1988.¹⁰ Meanwhile, "With the exception of Pakistan and possibly North Korea, China's arms trade with Iran has been more quantitatively and qualitatively comprehensive and sustained than that with any other country."¹¹

Adherence to the principle of non-interference in the internal affairs of other sovereign states enabled China to develop better relations with the Gulf countries without establishing formal bilateral diplomatic relations. Pilgrimages made by Chinese Muslims in 1979 provided a channel for China to improve its relations with Saudi Arabia. The United Arab Emirates (UAE) established diplomatic relations with China in November 1984 in the hope of having China influence Iran over the question of a maritime territorial dispute between Tehran and Abu Dhabi. Prince Bandar bin Sultan, then Saudi ambassador to Washington, made a brief visit to China in mid-October 1988, and both countries agreed to open commercial offices in the other's capital city. The improvement of Sino-Saudi relations gave impetus to China's relations with Qatar and Bahrain, which established diplomatic relations with China in July 1988 and April 1989 respectively. In July 1990, Saudi Arabia made the final step and established diplomatic ties with China. From Baghdad to Riyadh, the journey for China to establish diplomatic ties with all eight Gulf countries lasted 32 years.

China's successful arms trade with both Iran and Iraq during the Iran-Iraq War and the promotion of relations with Gulf Cooperation Council (GCC) countries benefited from the triangular relationship between the United States, the Soviet Union, and China. China still considered the Soviet Union the chief threat to its national security, because of the Soviet invasion of Afghanistan, Moscow's support for Vietnam, and the presence

of Soviet forces along the Sino-Soviet and Sino-Mongolian border. Beijing therefore continued its foreign strategy of alliance with the United States against the Soviet Union. Such a situation enabled China to hold a different position from Washington in regard to Iran. Iran and the GCC countries thought that the Soviet invasion of Afghanistan threatened the security of the Gulf region and therefore resistance to Soviet expansionism was a geopolitical interest shared between Tehran and Beijing.

Geopolitical interests played a leading role in Sino-Gulf relations, since China made use of these relations to bolster its position in relation to the two superpowers, and tried to gain the Gulf countries' support of its position towards Taiwan. After the implementation of reform and opening up of the Chinese economy, economic and trade interests became more and more prominent.

Iraq's invasion of Kuwait in August 1990 changed the focus on relations in the Middle East from antagonism between Iran and Arab countries to a triangular relationship between Iran, Iraq, and the GCC countries, and put forward a severe challenge to China's Gulf policy. Both Iran and the GCC countries had a common perception of Iraq under Saddam Hussein as their primary threat. For the United States, both Iran and Iraq remained an enemy in the Gulf, but Iraq's invasion of Kuwait in 1990 and the subsequent Gulf War between Iraq and U.S.-led forces meant that ongoing disputes between Washington and Baghdad were more urgent and severe than antagonism between Iran and the United States, which involved no open conflict. Generally speaking, Iraq was set as the chief target of international and regional pressure in the Gulf region.

Fundamental changes were evident in the international system from 1989. The Tiananmen Incident in 1989 worsened Sino-Western relations, and the collapse of the Soviet Union and the Eastern Bloc made China more isolated. Chinese leader Deng Xiao-ping instituted a foreign policy strategy of "observing calmly, securing our position, coping with affairs calmly" and "never claiming leadership, maintaining a low profile, making some contributions."

Such a strategy was embodied in "being based on Asia-Pacific region, stabilizing relations with neighboring countries, and going global" (*li zu ya tai, wen ding zhou bian, zou xiang shi jie*) as general arrangements of China's foreign policy.¹² China emphasized the Asia-Pacific region and the neighboring countries, and in relative terms, marginalized the Middle

East. Being “detached generally and involved appropriately” (*zong ti chao tuo, shi dang can yu*) began to be adopted as principles of China’s foreign policy in the region. “Being detached generally” meant that China (1) would reach a compromise with the United States on positions which Washington resolutely opposed and (2) would be tolerant about issues which did not threaten China’s core national interests. Being “involved appropriately” meant that China (1) could make use of positions which Washington did not oppose and (2) would strive for goals related to China’s core national interests. China’s attitudes to the Gulf War and Lockerbie Air Disaster—where Beijing understood and did not oppose British and American pressure on Libya and Iraq, despite maintaining friendly relations with Tripoli and Baghdad—are examples of this policy, as well as letting the United States check a Chinese container ship, the *Yinhe*, suspected of carrying sensitive materials to Iran in 1993. China was also sanguine about Taiwanese leader Li Deng-hui’s visit to the UAE and Jordan. The policy of “being detached generally and involved appropriately” represented a U.S.-centric orientation in China’s foreign strategy.

China’s foreign policy in the Middle East and the situation in the Gulf jointly made Iran the focus of China’s Gulf policy in this phase. The most obvious signals of good Sino-Iranian relations were visits made by leaders of each country to the other. In the 1980s, Akbar Hashemi Rafsanjani, then the Speaker of the Iranian Parliament, and Ali Khamenei, then president of Iran, made visits to China in June 1985 and May 1989 successively, and both met Deng. Wan Li, then chairman of the National People’s Congress (NPC) of China, visited Iran in September 1988. From 1990 to 2001, Chinese premier Li Peng (July 1991), President Yang Shangkun (October 1991), then Chairman of the NPC, Qiao Shi (November 1996), and then Vice-President Hu Jintao (January 2001) visited Iran successively; the speaker of the Iranian Parliament, Mehdi Karroubi (November 1991), then President Rafsanjani (1992), and then President Mohammad Khatami (June 2000) made visits to China.

Prominent signals of good Sino-Iranian relations centered on nuclear cooperation and the arms trade. China initiated civilian nuclear cooperation with Iran in 1985. In September 1992, China signed a nuclear cooperation agreement which provided that it would sell two pressurized water reactors to Iran, but cancelled this agreement in 1995. In 1997, China terminated civilian nuclear cooperation with Iran.¹³ During the 1990s

China was helping Iran in anti-ship cruise missile and ballistic missile technology, but informed the U.S. in September 1997 that it would halt all new cruise missile deals with Iran. On January 20, 1998, it informed the United States that it had stopped the anti-ship cruise missile exporting program to Iran.¹⁴ The leaders of China and the United States exchanged visits in October 1997 and June 1998, which resulted in the termination of the Sino-Iranian nuclear technology cooperation and a moratorium on the arms trade between China and Iran for a period of time.

Energy has emerged as a main factor in Sino-Gulf relations since the 1990s. In 1992, Deng delivered his famous South Tour Speech, which led to a rapid economic increase in China and a corresponding increase in China's oil demand. China became a net importer of refined oil products in 1993 and a net importer of crude oil in 1996. It increased its capability to refine high-sulfur crude oil, and deepened its energy relations with Gulf countries, making Iran become a main oil exporter to China. The Asian Financial Crisis of 1997-1998 forced China to explore markets in the Middle East and Africa. China imported energy from and exported industrial products to the Gulf countries. The bilateral trade volume between China and Iran was no more than \$120 million before 1978, and amounted to about \$0.5 billion in 1995 and about \$2.5 billion in 2000, and jumped to about \$3.3 billion in 2001. China began to import a large amount of crude oil from Iran in 1995. It imported 7 million tons from Iran in 2000 which accounted for 10 percent of the total value of China's crude oil imports. This rose to 10.85 million tons, or 18 percent of the total value, in 2001, making Iran the largest provider of crude oil to China.

Iran enjoyed no special advantages from China in regard to energy and trade compared to the Arab countries in the Gulf, and although the bilateral trade volume between China and Saudi Arabia, Oman, and UAE was also large, Iran was of special significance to China in the 1990s.

During that decade, the international system changed fundamentally after the Cold War, and so did Sino-U.S. relations, which were worsened by differences and contradictions. The U.S. government decided to sell weapons to Taiwan in September 1992, and permitted Taiwan leader Li Deng-hui to visit the United States in May 1995. The Taiwan Straits Crisis the following year presented the biggest challenge to Sino-U.S. relations. President Jiang Zemin's visit to the United States in 1997 and President Clinton's visit to China in 1998 signified improvements in the relationship,

but they deteriorated again because of the U.S. bombing of a Chinese embassy in Belgrade, Serbia in May 1999 and the collision between an American reconnaissance aircraft and a Chinese fighter in April 2001. Disagreements over human rights, the status of Tibet, and trade were also destabilizing factors in the relationship.

After the Cold War, the situation in the Middle East changed too. The Gulf War in 1990, the collapse of the Soviet Union in December 1991 and Moscow's subsequent retreat from the Middle East, and the signing of the Oslo Accord in 1993 were signals of America's dominant role in the Middle East.

At the same time, the Middle East including the Gulf became increasingly important to China. After the collapse of the Soviet Union, the newly independent Central Asian countries became targets of the expansion of Iranian, Turkish, and Saudi influence. Civil war in Afghanistan brought the Taliban regime into power in 1996. As a result, the inner region of northwestern China, which had been linked with the outside only through the Karakoram Highway in Pakistan, was now surrounded by neighboring countries seen as an arena of competition for the regional powers and even the United States and the other great powers in the world. The Middle East, though not a neighboring region of China, began to be regarded as a "strategic extension" relevant to the security of the western part of China.¹⁵ In addition to its long-standing significance to China's economic, trade, and energy interests, the Middle East became more prominent in China's geo-strategic calculus.

Against this background, the Middle East played an increasingly important role in Sino-U.S. relations in two dimensions: the relationship between China's core national interests and the dominant role of the United States in the region, and the relationship between Sino-U.S. bilateral relations and China's relations with the Middle Eastern countries. China had to find a pillar in the Gulf and the whole Middle East through which it could not only protect and develop its core national interests, but also balance the U.S. influence in the region, even on a global level.

In the Gulf region, the Saudi-led GCC countries were different from China in regard to ideology, so they misjudged China's internal political system and international position, believing that the collapse of the Soviet Union would also bring about significant political change in China. They were therefore cautious and even hesitated to develop closer relations with

Beijing. Iraq and Iran were subject to a U.S. dual-containment strategy, and moreover, Iraq was the focus of international sanctions. If China had to make a choice among these Gulf countries, Iran was the only possible choice as China's pillar in the Gulf region.

Iran's emergence as the pillar of China's Gulf policy coincided with the decline of Arab countries' position after the Cold War. Syria was greatly weakened with the retreat of the Soviet Union from the Middle East, Iraq was under continuous sanctions and became isolated, and both Egypt and Jordan realized peace with Israel. The Arab world was highly disintegrated and its position declined to some extent. China established diplomatic relations with Israel in 1992 to treat Israel and Arab countries equally and to implement a hedging policy among this regional uncertainty.

In the 1990s, China adopted a policy of "never claiming leadership, maintaining a low profile, and making some contributions" as its foreign strategy, which was embodied in "being detached generally and involved appropriately" as its Middle East policy. The essence of such a pragmatic foreign policy was a compromise between China's core national interests and the dominant role of the United States in the Gulf and the Middle East. China's pragmatism in the Middle East fell into two categories: a focus on economic, trade, and energy sectors meant that China would downplay ideological differences with pro-American governments in the Gulf. Meanwhile, China would develop comprehensive relations with anti-American governments and benefit from their balancing role, under the precondition of not challenging the core interests of the United States. Tehran was a key government in the second category.

FOCUSING ON SAUDI ARABIA AND IRAN (SINCE 2001)

The 9/11 terrorist attack in 2001 changed Sino-U.S. relations as well as the situation in the Gulf and the Middle East. After the terrorist attack, China supported the United States in its anti-terrorist war in Afghanistan in 2001, and acquiesced to Washington in the Iraq War in 2003. Closer Sino-U.S. relations have been achieved since 2001. Factors such as the 9/11 terrorist attack in 2001, the Iran nuclear program that was uncovered in 2002, and the Iraq War in 2003 led to fundamental changes in the Gulf region.

Better Sino-U.S. relations and the fundamental changes in the Middle East prompted China to choose Saudi Arabia and Iran as its focuses in the Gulf.

China and Saudi Arabia since 2001

The strategic significance of Saudi Arabia to the United States lies in the U.S. need to secure a stable flow of oil at reasonable prices, its battle with anti-Islamic extremism, the importance of the Middle East peace process to Washington, and the need to balance Iraq while containing Iran. The 9/11 terrorist attack influenced U.S.-Saudi relations negatively to some extent. A terrorist attack in Saudi Arabia in May 2003, as well as the Iraq War and Iranian attempts to create nuclear infrastructure, forced Saudi Arabia to cooperate with United States more closely. However, Riyadh found that it was necessary to hold a more balanced position in its international relations and play a more active role in the Arab world. Prince Abdullah became the new Saudi king in August 2005, and since then “has sought to strengthen Saudi relations with European and Asian counterparts and has worked to build and lead an Arab consensus on regional security issues such as Lebanon and the Israeli-Palestinian conflict.”¹⁶ Developing closer relations with China is in line with Saudi geopolitical interest.

Economics, trade, and energy cooperation between Saudi Arabia and China has strengthened rapidly, especially after China joined the WTO in 2001. Saudi Arabia has become China’s largest trade partner in the Middle East, and the bilateral trade volume reached \$41.8 billion in 2008. China is the main market for Saudi oil, importing 26.33 million tons of crude oil from Saudi Arabia in 2007, and 36.37 million tons and 41.86 million tons in 2008 and 2009, respectively. Saudi Arabia has become the largest provider of crude oil to China, and the PRC imported more Saudi crude oil than the United States in 2009, thereby becoming the largest importer of Saudi crude oil in the world.

Non-traditional security is a new area of Sino-Saudi cooperation. The situation in Afghanistan and Pakistan and terrorist attacks in Xinjiang forced China to dedicate more efforts to fighting terrorism, separatism, and extremism. Indeed, facing non-traditional security challenges has become a new core interest of China in the Gulf region, especially in Saudi Arabia, which is an influential country in the Islamic world and keeps close ties

with Pakistan. Cooperation with Saudi Arabia to face non-traditional threats is of special significance to China.

Framed within these mutual interests and needs, Sino-Saudi relations have been developing rapidly. King Abdullah made a formal visit to China in January 2006, which was the first visit made by a Saudi king to the PRC since the establishment of diplomatic relations between the two countries. President Hu Jintao visited Saudi Arabia in April 2006 and February 2009, and Vice President Xi Jinping also made a visit to Saudi Arabia in June 2008.

China and Iran since 2001

The rise of Iran in the beginning of the twenty-first century is the most profound and significant event in the Gulf and the whole Middle East. Many factors contributed to such a course. Firstly, Saddam's regime in Iraq and the Taliban regime in Afghanistan, the two most formidable regional enemies of Iran, were both overthrown by the United States. Secondly, Iran expanded its influence in the Middle East and Central Asia through Persian culture and Shiite faith. King Abdullah of Jordan expressed his concerns in December 2004 about an emerging "Shiite Crescent," beginning in Iran and extending through southern Iraq to Syria and Lebanon. Actually, a Shiite-cum-Persian Gulf belt exists and has played a pro-Iranian role in the Arab countries in the Gulf since the Islamic Revolution. One of the results of the Iraq War was to link the Shiite-cum-Persian Gulf belt more seamlessly together in southern Iraq. Thirdly, oil prices increased dramatically from 2003 to 2008, and provided Iran with enough funds to support various programs. Fourthly, the outbreak in 2000 of the Second Palestinian Intifada in the Occupied Territories represented a setback for the Middle East peace process and ignited a new wave of anti-American sentiments among Muslims. This anti-Americanism was fueled by the Greater Middle East Initiative, a plan to encourage the democratization of the Muslim world presented by the Bush administration in 2004. All these factors could be calculated as reasons for the rise of Iran.

The Iran nuclear issue has intensified the antagonism between Tehran and Washington. From August 2002 to August 2005, Britain, France, and Germany tried to convince Iran to suspend its nuclear program through diplomatic efforts; thereafter the "Iran Six" (or Five plus One)

mechanism, which consists of the five permanent members of the United Nations Security Council and Germany, came into being, and the direct antagonism between Iran and the United States became the dominant factor in negotiations. Moreover, Iran's anti-Israel president Mahmoud Ahmadinejad came to power in 2005. The rise of Iran, a bitter antagonism between Iran and the United States, combined with the anti-Israel position of the current Iranian government, made Iran the core concern and main target of U.S. policy in the Gulf region. Although the Obama Administration has adopted a policy of engagement since 2009, the United States did not change its attitude on the Iran nuclear issue and Tehran's position toward Israel.

The rise of Iran and a bitter Iran-U.S. antagonism composed the background of Sino-Iranian relations in the first decade of the twenty-first century. Iran is extremely significant to China's geopolitical and energy interests, as well as to economic, trade, and non-traditional security interests, so China must keep at least one eye on Iran. At the same time, on the global level, Sino-U.S. relations are defined as the most important bilateral relationship, and China must consider core American concerns. In other words, it should not damage relations with Washington by unconditionally supporting Iran. China has to take a pragmatic approach. After the two visits made by Hu Jintao as vice president in January 2001 and Jiang Zemin as president in April 2002, Chinese presidential and prime ministerial visits to Iran stopped, although Ahmadinejad visited China in September 2008. The summit of the Shanghai Cooperation Organization has become a good chance for the leaders of the two countries to exchange views, and they met in Shanghai in June 2006, in Bishkek in August 2007, and in Yekaterinburg in June 2009.

Challenges to China's Gulf Policy

Some internal contradictions exist in China's current Gulf policy. The first contradiction arises from the bilateral relations between the United States, and Saudi Arabia and Iran, respectively. The second contradiction lies in the competition or even antagonism between Saudi Arabia and Iran since the 1979 Islamic Revolution in Iran. And the third, between China's increasingly important core national interests in the Gulf region and its pragmatist policy.

For Saudi Arabia, all neighboring countries, for example, Iran, Iraq, Egypt, and Israel, are regional great powers. Although Saudi Arabia is wealthy and abundant in oil reserves, it is weak militarily, and has been facing security challenges. The Yemen Civil War of 1962-1970, the Islamic Revolution of Iran in 1979, and the Gulf Crisis and Gulf War in 1990 and 1991 all demonstrate how serious such challenges can be. The United States provides the ultimate strategic security guarantee to Saudi Arabia. Saudi Arabia is of great significance for China's core national interests, but its foreign policy is pro-American because of its need for security guarantees which can, for the time being, only be met by the United States. China lacks the ability to provide such a security guarantee, and is not sure how far the Sino-Saudi friendship can go.

The antagonism between Iran and the United States also restricts Sino-Iranian relations. China could use Iran to balance the United States. Iran is also a possible barrier protecting the western part of China from various threats, and its influence in Afghanistan and Central Asia is helpful for China. Moreover, Iran is the only independent source among the large oil and natural gas providers for China, and the sanctions enforced by the Western countries give Chinese companies more opportunities in Iranian markets. In areas related to non-traditional security, Iran has kept traditional and cultural contacts with the Muslims in Central Asia, Xinjiang and the interior of China, and could make use of such contacts to influence China's policy, although it has refused to do so, insisting instead on detachment from Muslim affairs in China. There is no doubt that Iran is of vital strategic significance, but China has to consider American concerns about Iran, especially related to the Iranian nuclear issue. To what extent China can support Iran is still unknown.

The extent to which China can maneuver around the pro-American regime in Saudi Arabia and the anti-American regime in Iran is a question that will test China's Gulf policy. Saudi Arabia is a conservative monarchy based on Sunni Wahhabism, while Iran is an Islamic republic based on the theory of the Guardianship of the Jurisprudent (*Vilayet-i Faqih*) of Imam Khomeini (1902-1989). The two great powers in the region are competing for the leadership of the Islamic world. In the 1980s, differences on the issues of Shia Muslims in the eastern province of Saudi Arabia, the pilgrimage of Iranian Shia Muslims, and the security of the Gulf region drove a wedge between the two. After the Cold War, Saudi Arabia has

became the most influential Arab country, although the position of the whole Arab world is declining, while Iran has been a rising great power in the Gulf since the beginning of the 21st century. An ascending Saudi Arabia and a rising Iran are face to face in the Gulf. Saudi Arabia is worried about Iran's nuclear program, and strikes a pose of moderation toward Israel in contrast to Ahmadinejad's anti-Israel position. Riyadh also supports Sunnis and pro-Western forces in Lebanon against Shia militant groups such as the Amal Movement and Hezbollah which are supported by Iran and Syria, and is trying to contain the Shia in Iraq for fear of the expansion of Iranian influence in Iraq. The animosity between Saudi Arabia and Iran could affect China's relations with either of them.

China is finding that more and more of its core national interests are in the Gulf region, and defines the Middle East including the Gulf region as its "Greater Neighboring Areas" (*da zhou bian*).¹⁷ The general arrangements of China's foreign policy have shifted to encompass four points: "great powers are crucial, neighboring areas are most important, developing countries are bases, and multilateral mechanisms are important arenas" (*da guo shi guan jian, zhou bian shi shou yao, fa zhan zhong guo jia shi ji chu, duo bian shi zhong yao wu tai*). To define the Middle East as a part of China's "Greater Neighboring Areas" therefore means according it a higher position in China's foreign strategy. In the Middle East, the Gulf region is more important to China compared to the Mediterranean region. Accordingly, China is implementing pragmatic policies in the region, which are unsuitable and even incapable of serving China's core national interests. King Abdullah became the king of Saudi Arabia in August 2005 and Ahmadinejad was elected as Iran's president in June of the same year. However, the Chinese president has visited Saudi Arabia twice since 2005 but made no visit to Iran. Although China does not mean to lean to Saudi Arabia to the expense of Iran, it has nevertheless left that impression in the region. This has played a negative role in Sino-Iranian relations.

The Gulf region will be more and more important to China's geopolitics, economics, trade, energy, and non-traditional security calculations, but China has to carry out pragmatic policies in the region to maintain Sino-U.S. relations and to avoid disputes between the Gulf countries. The most prominent contradiction is between China's interests in the region and its attempt to maintain smooth relations with the United States in its overall foreign policy.

China's pragmatism is based on its judgment of the current international system. The United States is still considered as the chief source of threat to China's security, for "the United States, as the single superpower, is the only country which has the capability and intention to threaten China comprehensively in the foreseeable future."¹⁸ At the same time, China can find few friends in the world, because developing countries are disintegrated and the international socialist movement is at low ebb, which means that the international system dominated by the United States is unassailable for the time being.¹⁹ "Most of the non-Western countries intend to restrain the United States and the Western great powers through the international system, and to realize mutual interests in the process of mixing and merging instead of challenging the dominant position of the United States."²⁰ Iran, the Democratic People's Republic of Korea, and some Latin American countries are trying to challenge the United States and are now isolated from the current international system. China realizes this, and the United States is the most important factor influencing China's foreign strategy, and China can only adopt a pragmatic position towards the Gulf region.

ENDNOTES

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THE VITAL TRIANGLE

Jon B. Alterman

For the United States, China's increasing involvement in the Middle East represents the convergence of two major security problems. The first concerns China's rise, which depending on perceptions, either needs to be accommodated or needs to be shaped. The second has to do with energy security, which the United States began to take seriously after World War II and has taken increasingly seriously since the Arab oil embargo of 1973-74. Each problem set has its own specialists, its own disputes, and its own dynamics, and the intersection between the two is an increasing preoccupation of analysts in Asia, in the Middle East, and in the United States.

As I look at this problem, I see a triangle. On the one hand, we have a U.S.-China relationship of considerable complexity. The U.S. Pacific Command (PACOM) is by far the largest of the combatant commands, outsizing even the Central Command, which is currently fighting two wars. China is clearly the principal focus of PACOM's activities, and China's increasingly robust naval capabilities are forcing new thinking about the U.S. military presence in Asia. This is not, however, a new Cold War. The Sino-American trading relationship is the second-largest trading relationship in the world, exceeded only by the trade between the United States and Canada. As has been often remarked in the press, China holds more than \$900 billion in U.S. debt, giving the country a considerable stake in the fate of the American economy. The United States and China are clearly not two superpowers on the brink of nuclear war.

Quite separate from the Sino-American relationship is the U.S.-Middle East relationship. The United States has positive relations with most governments in the Middle East, but these are relationships principally of dependency. Most governments in the Middle East—and especially in the oil-rich Gulf—rely on the United States for defense, especially against

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foreign foes. The United States sells billions of dollars of weapons to Middle Eastern governments every year, in part to deter potential regional enemies. Around the Gulf, the United States has military bases in each of the Gulf Cooperation Council countries except for Saudi Arabia. The economic ties are less vital. The United States is not the principal oil export market for any country in the region, nor is any Middle Eastern country the principal source for U.S. imported oil.¹ In fact, Saudi exports to the United States have flattened and China is now the principal destination for Saudi oil.²

There is also the third relationship, the Sino–Gulf relationship. That relationship has been rapidly expanding, driven in part by a hunger for Chinese manufactured goods and construction in the Gulf, and an unslakable thirst for the oil that helps drive the Chinese economy. Whereas U.S. oil demand is stagnant, Chinese oil demand is growing strongly and is projected to continue to do so. What is striking about the Gulf–China relationship is how economically driven it is, compared to U.S. relationships with each party. China relies on security in the Middle East, but it does not feel obligated to promote it. In fact, China shared the view of many in the energy business during the Bush administration that the U.S. government was a key source of instability in the Middle East because of its military actions and its aggressive attacks on the political status quo.

Analysts in the United States are used to thinking about bilateral relationships, but are not very good at thinking about trilateral relationships. There has been an impulse in U.S. foreign policy to force countries to choose—“you’re either with us or the terrorists”—with exceptions made for countries such as Finland and Yugoslavia whose geography made full alignment with the United States unthinkable. The only way to think of the relationships among the United States, China, and the Gulf is as an inescapable triangle, with the additional understanding that if any two sides of the triangle gang up on the other, the one left out can make life miserable for the other two. That is to say, no party can force the United States out of the Gulf, or keep the Chinese out. Similarly, it would be hard to sustain a Sino–American effort to squeeze Gulf oil producers, although that would have as much to do with cheating on the U.S. or China side as with creative mischief-making on the Gulf side. Going forward, our goal should not be to deny the triangle, but instead to embrace it. It may be hard to imagine how China can play a truly substantial and constructive

role in the Gulf, but it seems even harder to imagine an alternative scenario working better.

This is not an impossible task, and it is made easier by the fact that all three sides in the triangle share a basic strategic interest in regional stability and the free flow of energy. Those common interests create a platform for cooperation that can enhance not only security in the Middle East, but also Sino-American relations more generally. The Middle Eastern piece of this puzzle is a small but significant one.

THE UNITED STATES IN THE MIDDLE EAST

The Middle East has been a central focus of U.S. strategy for six decades. The United States moved into the region in the aftermath of World War II, when Britain left the Levant, and moved in further after Britain pulled out of the Gulf in 1971. For four decades, the U.S. position in the Middle East sought to block Soviet influence, and for the last decade or so, the United States has sought to limit the influence of radical Islam. Over the last half century, the U.S. government accustomed itself to the prevailing order of the Middle East and determined that its strategic interests relied on that order's preservation.

The numbers tell an impressive story. Some scholars suggest that from 1980 to 1990, the United States spent approximately \$33 billion per year defending Middle Eastern oil supplies, with one analyst estimating that the figure for 2003 ranged between \$37 billion and \$44 billion.³

China's rising engagement in the Middle East has raised concerns in at least two areas. The first, and the longer-running one, has to do with weapons sales. Several times in the last decade, China has sold advanced weaponry to countries that are potential foes of the United States and has sought to obtain advanced U.S. military technology from friendly countries. Beginning in the Iran-Iraq War, it sold various anti-ship missiles to the Islamic Republic of Iran, including Silkworms and sophisticated guided anti-ship missiles. Beijing's weapons relationship with Tehran has taken on a new strategic significance since China became a net oil importer in 1993. Weapons transfers became part of the process of mutually beneficial exchange whereby China could secure energy deals with Iran.

U.S. military planners fear that Chinese anti-ship missiles could help Iran resist U.S. military efforts if conflict breaks out in the Straits of Hormuz.⁴ One such anti-ship missile, a likely Iranian clone of the Chinese-made C-802, was fired by Hezbollah forces during the Lebanon war of 2006, hitting an Israeli ship off the coast of Lebanon. The attack killed four Israeli crewmen and did significant damage to the ship.⁵

There is another military angle as well. For many years, China has sought to obtain U.S. military technology, several times seeking sales through Israel that are proscribed by U.S.-Israeli agreements. In 2000, the United States forced Israel to withdraw from an earlier contract to sell four command and control aircraft containing U.S. technology to China. A 2004 agreement to upgrade and modernize China's armed drones with U.S.-derived technology aroused so much anger that the Bush administration demanded a written apology and the resignation of the director general of the Israeli Ministry of Defense.

The other area of concern is Chinese diplomatic activities, which many in the United States see as undermining efforts to preserve order in the region. The United States considers blocking any Iranian nuclear weapons capability a vital U.S. interest. China professes a similar desire, but Chinese representatives are clearly reluctant to impose additional sanctions on Iran, and outwardly present themselves as optimistic that tensions will be successfully managed through a diplomatic process. In private, however, Chinese officials profess fear that the United States is not motivated by non-proliferation concerns, but rather by aspirations of regime change and see such a move undermining peace and stability in the Gulf rather than strengthening it. Meanwhile, American critics of China's actions see Beijing's actions as cynical, making deals for cheap Iranian oil and relying on the United States to limit the fallout if Iran succeeds in developing and deploying a nuclear weapon. Some even think that that China is looking to abet U.S.-Iranian tension as a way of constraining U.S. influence in the Gulf.

When it comes to military affairs in the Middle East, Beijing treads lightly. China has been a major beneficiary of the enormous U.S. efforts to maintain stability and security in the greater Middle East. Chinese leaders are not completely content with Washington's management of regional security affairs and have sometimes pursued policies and trade relations that undermine U.S. efforts. Nevertheless, they have avoided

challenging U.S. predominance or major policy initiatives. In response to U.S. pressure, Beijing has curtailed certain arms sales to Iran and supported UN Security Council efforts to encourage Iran to suspend its uranium enrichment program. On the positive side, China has contributed peacekeepers to Lebanon—its first commitment of troops far afield—and it has several ships patrolling against piracy off the coast of Somalia. China's military activities in the Middle East clearly seek to reinforce the status quo, in sharp contrast to its Middle Eastern policies in the 1960s and 1970s.

Overall, China has had a strikingly unsentimental approach to the Middle East, which stands in contrast with the sometimes emotional overtones of Middle Easterners looking at their great power relationships. Many Middle Eastern states have had long and involved histories with the United States, but they see China as an investment in their future. Contemporary Middle Eastern views of China are similar to Middle Eastern views of the United States a century ago, when many in the Middle East looked to the United States to rescue them from European imperialism. Aloof from the struggles that had tested the Middle East throughout the nineteenth century and largely without clients in the region, the United States was viewed by an earlier generation of Middle Easterners as precisely the kind of honest broker that could help forge states from the ashes of the Ottoman Empire. U.S. president Woodrow Wilson's championing of the idea of self-determination helped elevate the image of the United States in the region, and although there was disappointment in some quarters that the United States would not accept the mandate for Palestine, the refusal served to reinforce the notion that, unlike European countries, the United States sought neither power nor subjects in the Middle East. China now seeks to cultivate the benefits of being just such a disinterested outside power.

THREE BASIC IDEAS

Looking forward, some basic ideas are worth keeping in mind. First, *U.S. interests in the Middle East are strategic and enduring*. For more than a half century, U.S. interests have centered on energy security—not so much for American consumers, but for the global market, consisting largely of U.S. friends and allies in Europe, East Asia, and Latin America. Securing the stable, uninterrupted flow of oil at reasonable prices has remained a

high priority for the United States, and promoting the stability of friendly regimes has consistently been an important means to that end. U.S. interests in the Middle East go beyond energy, however. The United States maintains a strategic interest in the security of Israel. In addition, the global U.S. defense posture is increasingly concerned with devising effective methods to combat terrorism and other forms of asymmetrical warfare that are often tied to combatants or grievances originating in the Middle East. Other interests also help shape interests in the region, from non-proliferation to non-oil trade and investment. The events of September 11, 2001 gave both importance and urgency to the Middle East for U.S. policymakers. Global reliance on oil, and the U.S. role in ensuring the availability of Middle Eastern oil, seems assured for several decades to come.

At the same time, the United States remains keenly interested in China. While some in the United States look with alarm at China's growing capacity and fear a rival superpower in the making, few doubt that China's size and impressive economic growth will continue to reshape the global balance of power.

Second, *Chinese interests in the Middle East are significant and growing.* China is acutely aware of its need to import oil to support its growing economy, and much of that oil will come from the Middle East for many decades to come. That plain fact is the consequence of two realities: first, the Middle East has the largest proven reserves of oil in the world, and second, China is far closer to the Middle East than other potential sources of oil such as West Africa or Latin America. While many Chinese scholars perceive a strategic imperative in conservation and pursuit of alternative energy, their nation's immediate needs suggest a deepening of economic ties to the region. Additionally, the increasingly sophisticated behavior of China's state-owned energy conglomerates demonstrates that they are no longer simply seeking equity oil to meet China's needs. This further suggests that even if China's demand for oil were reduced, the future prosperity of large Chinese companies is now inexorably linked to that of the global oil market as a whole and Middle Eastern oil in particular.

Compared to the United States, however, China's interests are relatively uncomplicated. Beijing has walked away from its past as a supporter of liberation movements, and while it feels a need to crack down on terror groups based in the far western provinces of China, those groups do not have nearly the same centrality in Chinese strategic thinking that

anti-Western terror groups have in the United States. China desires positive relations with all parties in the Middle East, and it has largely been able to achieve its goals. The fact that China has been able to build relatively close ties with both Israel and Iran is only partly a sign that Beijing views neither relationship as strategic; even more so, it is a sign of the deftness of Chinese diplomacy.

What is truly strategic to China is its relationship with the United States. Convinced that an antagonistic relationship with the United States would degrade China's interests around the globe, the Chinese government carefully weighs actions that might compromise core U.S. interests. China clearly sees the depth of U.S. engagement in the Middle East and is loath to challenge it. To a degree, the Chinese see themselves benefiting from American missteps in the Middle East. As Washington pours resources into wars in Iraq and Afghanistan, the resulting popular resentment towards the United States in the region redounds to China's benefit. China seems inclined to help the United States in modest ways, but it feels no need to assume a leadership role in policies it sees as deeply misguided.

Interestingly, China may not share the U.S. commitment to regime stability in the area. Whereas the United States is committed to securing the stability of friendly governments as a way to ensure its interests in the region, China seems more agnostic on this point. Either China believes that it cannot make a material difference in the stability of such governments, or that U.S. efforts in that regard are sufficient to safeguard China's interests. China appears to be banking on the fact that it is a sufficiently attractive market that any given regime will sell it oil. Maintaining a low strategic profile, in fact, helps to prevent ideological opposition in the region to supplying China with oil.

Finally, *the Middle East's interests in the United States and China are evolving*. As recently as a few decades ago, the Middle East looked almost exclusively westward for both its markets and its security. Westerners helped develop the region's oil production, Westerners purchased much of that oil, and Westerners helped create the state of Israel in their midst. The Soviet Union had relatively less influence. For all of its efforts in the region, the Soviet Union never transcended principally military relationships with regional governments, and in the event, those relationships were mostly with relatively poorer countries such as Egypt and Syria, or very poor ones such as south Yemen. The idea of developing deep ties with China seemed

far-fetched not only for the region's governments, but even for the armed movements that opposed them.

To a great extent, Middle Eastern countries continue to look westward. The United States remains the most powerful and most agile fighting force in the region, and it brings potent tools to the table in governments' struggle against both international and domestic terrorism. U.S. technology in everything from weaponry to software to oil recovery is the best in the world, and U.S. organizational practice—in business, government, and the military—is a consistent force multiplier in addressing problems.

While only a handful of countries in the Middle East seek deep relationships with China to rival the kinds of relationships many others have with the United States, there is widespread curiosity about what a deeper relationship with China might hold. In part, this curiosity is driven by dissatisfaction with a U.S. presence that Middle Eastern nations see as both heavy-handed and incompetent. The failure to make progress on Arab-Israeli peace issues, the Pandora's box opened in Iraq, the resurgence of Iran, and the clumsy efforts to pressure friendly Middle Eastern governments to democratize have all dimmed the promise that regional governments see in a close U.S. partnership. For energy producers, a rise in American rhetoric on energy independence, combined with relatively flat U.S. demand growth for oil in recent years, suggest that a close relationship with the United States is insufficient to protect their interests.

Important, too, is a sense among many regional countries that bilateral relations with China can supplement relations with the United States without detracting from them. Even U.S. allies who would not want to provoke full-scale rivalry between the United States and China see deeper relations with China as enhancing their bargaining positions vis-à-vis the United States. This is even truer of U.S. foes in the region that are desperate to escape from U.S. constraints, and are thus willing to provide especially attractive opportunities for Chinese investors willing to defy U.S. demands.

WHERE DOES THIS GO?

The challenge to all parties is to boost cooperation in areas of common interests, especially at a time when the United States is feeling strategically

vulnerable, is wary of China emerging as a potential global rival, and is fiercely protective of its role in maintaining Gulf security. China, for its part, often falls back on a conception of the United States as a global hegemon; as such, China believes that the United States seeks to hem China in rather than enhance common interests.

China could be forgiven for evincing satisfaction with the current state of affairs, in which it has access to all markets, the United States alienates many of those whom it seeks to protect, and China is able to freeload on the U.S. policy of securing the sea lanes. However, such a state of affairs increases the possibility of Sino-American tension that degrades the interests of each. There is also something inherently unstable in a Middle Eastern order that relies on the West for its security and the East for its prosperity. Something will have to give.

Rather than being a source of tension, the keenly shared U.S. and Chinese interests in Gulf security means that the region can be a locus of cooperation between the two sides, which can work in partnership with host governments.

There is little question that the Middle East can emerge as a key bone of contention between the United States and China, exacerbating what is already a sometimes tense relationship. The United States government sees the region as the most critical in the world, witnessed by the commitment of resources it continues to make in regional stability. It would be easy to see China as a spoiler in this vital region, poisoning not only cooperation in the Middle East, but also farther afield. Furthermore, some regional countries seem to see an interest in stoking a rivalry between the United States and China as a way of advancing their own interests. They do so either by encouraging China to evade U.S.-led sanctions or encouraging a bidding war between the two sides. Whereas some in the Middle East may see such a rivalry to their advantage, it would be likely to diminish regional security rather than enhance it, leaving regional powers less secure than they already are, and certainly undermining the prospects of Sino-American cooperation in the region and further afield.

There is good news in all of this. It appears that China is not and does not seek to be a rival of the United States in the Middle East. Indeed, China's diplomacy is very clearly oriented toward not confronting the United States in the Middle East (or elsewhere, in most cases). In addition,

China has benefited tremendously from the security that the United States provides.

At the same time, however, many Chinese believe that U.S. actions in the region have undermined stability and thus hurt Chinese interests. There is an ongoing temptation for China to deal directly with countries that the United States is seeking to isolate, thereby picking up valuable assets at fire-sale prices. In other words, while there is no immediate conflict, the conditions under which conflict might arise are not hard to imagine.

Each side—China, the United States, and the Middle East—has a deep interest in promoting greater cooperation throughout the “Vital Triangle,” recognizing common interests and acting in such a way as to promote them in concert. Such cooperation would have the benefit not only of enhancing security in the Middle East, but also of creating a pattern of security cooperation between the United States and China that would infuse a host of other engagements around the world.

ENDNOTES

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LOOKING EAST: A GULF VISION OR A REALITY?

Emile Hokayem

For the Arab states in the Gulf, the rapid rise of China carries as much opportunity as uncertainty. China's mere size makes it a country impossible to ignore or alienate, for there lie gigantic economic prospects. In fact, an ascendant China is at the center of a charm campaign by the Arab Gulf states that seek markets for their oil, gas, and petrochemical products, and scout for investment opportunities in rapidly-growing Asia. At the same time, for countries that expect their relations with major powers to feature a strategic dimension that takes their complex security interests into account, China's ambitions in the Middle East remain difficult to discern and navigate.

THE ENCOUNTER OF CHINA AND THE ARAB GULF STATES

At its birth in 1949, the People's Republic of China had all the hallmarks of a state inimical to the identity and strategic posture of the Arab Gulf states (some then still in their infancy, others not yet independent)—atheist, communist, revolutionary, insular, pro-Soviet, anti-West, militaristic, Third-Worldist, and in its own way, republican. It is no wonder that the Arab Gulf states—conservative, religious, monarchical, pro-Western, capitalist—had to wait for the Chinese revolution to mature (or some would say, mellow) before opening up to Beijing. Kuwait was the first Arab Gulf state to establish relations with China in 1971, followed by Oman in 1978, the United Arab Emirates (UAE) in 1984, Qatar in 1988, Bahrain in 1989, and Saudi Arabia only in 1990. Once China initiated a rapprochement with its neighbors and the West, and prioritized economic development

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and access to the resources and markets to sustain it, the Arab Gulf states were able to engage China at a level they felt comfortable with. From their perspective, the encounter with China does not amount to a meeting of hearts or minds nor is it the logical product of a shared history, cultural affinity, or geographical proximity—all of which are arguably minimal (China however, had older and deeper interactions with some parts of the Middle East, including Iran). Rather, from the Arab side, the relationship is driven by a pragmatic recognition of shared economic interests and awareness that the center of global gravity is moving east. Indeed, along with many other countries, the Arab Gulf states sense that history is going Asia's and China's way, although which way and what place they will have in it remain unclear. Yet the density, multi-dimensionality, and current pace of Gulf-Asia relations, of which Gulf-China relations are fast becoming the most important subset, are such that interdependence between these two areas is probable in the coming decades.

ENERGY AND TRADE

Energy is undoubtedly the primary driver of the Gulf-China relationship today, and will remain so in coming decades. To fuel its growth, China needs to devise an energy security strategy that acknowledges the centrality of Gulf oil, Arab and Iranian. China already buys almost 50 percent of its imported oil from the Middle East and, combined, the Arab Gulf states are already China's largest foreign oil supplier. By 2030, oil imports from the Middle East are expected to grow by a factor of 5, gas imports by a factor of 4. By then, China will have overtaken Japan and India as the top Asian client of the Arab Gulf states.

The Middle East, especially the poorer parts, is also a growing market for a wide range of Chinese products. Though the Arab Gulf states may still be hooked on high-end Western products, the success of DragonMart in the UAE (a major center of Chinese trade in Dubai, where 4,000 Chinese businesses are housed) suggests that low-tech Chinese products will soon dominate markets. Flush with capital and increasingly wary of the West, the Arab Gulf states view the Chinese market as immense, growing, and hungry not just for oil but also for petrochemical and metallic products—two industries that the Arab Gulf states are heavily investing in as part of

their economic diversification strategy. Though in the early stages, Arab Gulf firms are showing increasing interest in real estate, infrastructure, industry, tourism, capital markets, and joint ventures with their Chinese counterparts. According to McKinsey & Company, by 2020, China-GCC trade will reach \$350 billion. The China-GCC Free Trade Agreement seems to have high priority in Beijing as well as in Arab Gulf capitals.

THE POLITICS OF THE RELATIONSHIP

Beyond economic common sense, the Arab Gulf's interest in China can be explained by other factors. A rising China seems to be in full control of its strategy and destiny. China has all the traditional attributes of power: a seat at the UN Security Council; nuclear weapons; growing regional clout; a modernizing military; alliances with other middle powers; memberships in main economic governance fora like the G20. Thus, the Arab Gulf states widely view China as an architect of any new world order, a superpower in the making—one that requires careful courting as evidenced by the fact that the first visit of Saudi king Abdullah outside the Middle East was to Beijing, not Washington. China also knows how to reciprocate. Sheikh Mohammed bin Zayed, the Crown Prince of Abu Dhabi, was welcomed in China with an honor guard in 2009.

In fact, the Chinese model of balancing economic development, state modernization, and political control has an unmistakable and reassuring appeal for the Arab Gulf states that aim to carefully manage their economic and political transformation. Discussions of a (very loosely-defined) “Chinese model” are rife in Arab political and intellectual circles. The Arab Gulf states also appreciate modern China's no-nonsense, businesslike approach to international affairs. China carries no toxic legacy of colonialism, no unwarranted scrutiny of domestic issues, no political, labor, or environmental conditionality, no cumbersome domestic politics to navigate, no political toxicity, and no fear of strategic adventurism. The Dubai Ports World episode in the United States, in which a Dubai government-owned business sought to acquire U.S. ports operators only to face massive and disparaging opposition from the U.S. Congress and media, would simply not happen with China.

However, as China deepens its economic ties with the Middle East, relations will inevitably become more complex. Chinese interests and assets in the region will also be readily apparent, as evidenced by the revelations of a plot by Uighur activists to bomb DragonMart. The fate of the Muslim Uighur community in China has received Arab media attention during the Xinjiang unrest of 2009 in which Beijing countered through quiet outreach to Arab Gulf leaders. The Arab Gulf states have remained sensitive to Chinese concerns as well, downgrading their relations with Taiwan and refraining from making statements of concern on the Uighurs.

REGIONAL SECURITY AND BALANCING CHINA'S RISE AND THE INTERESTS OF OTHER EXTERNAL PLAYERS

China's entry into the Middle East is not happening in a vacuum. The Gulf is already an internationalized political and security space in which the United States remains, by far, the main external actor. However, questions about the strategic wisdom and operational competence of the United States have surfaced in the region as a result of the wars in Iraq and Afghanistan. In addition, the Arab Gulf states are keen to portray the security of their region as a global public good rather than as a predominant American interest, since the American security umbrella comes at a high political cost. In the United States itself, appetite for military deployments abroad is also decreasing. These trends create an environment susceptible to the entrance of new players in Gulf security, of which China is perhaps the most anticipated.

The question is whether China is interested and capable to contribute to Gulf security beyond its role as a permanent member of the United Nations Security Council. As consumers of security, the Arab Gulf states expect their major partners to play a security role in the Gulf. The question on their minds is whether China will be willing and able to play such a role, and whether this will be desirable at all.

Chinese calculations over its strategic interests will determine if their involvement will deepen. For the moment, China is a free rider benefiting from U.S. protection of its supply lanes, but it may decide that letting the United States guarantee its energy imports is not a safe energy security strategy but rather destabilizing, carrying enormous risks. At the same

time, China is focused on its immediate volatile neighborhood, from the Korean Peninsula to Taiwan to the Sea of China, where regional rivalries could escalate. Investing in power projection capabilities would thus divert precious resources. China also seems unwilling to shoulder the political burden of involvement in the myriad interconnected and unforgiving Middle Eastern conflicts. So a precious and important irony resides here: China officially decries the role of foreign actors in the Gulf as destabilizing, but the very reason why the Gulf states are courting China is because it fits in with their strategy to internationalize Gulf security.

For the time being, China's military engagement in the Gulf is minimal. It takes part in a naval exercise off the coast of Somalia and in the Gulf of Aden to combat piracy. Two participating ships even paid a visit to the port of Abu Dhabi in 2010, heralded as an example of greater Chinese military assertiveness. Still, despite Chinese investment in a blue-water navy, it will take years, a significant logistical leap, and a major decision for China to become a military power in the Gulf.

China could increase military cooperation with the Arab Gulf states by selling weaponry, but it is unlikely that the Gulf states as prime buyers of top-quality Western military hardware would settle for lower quality weaponry from China other than for symbolic and political reasons. China as a military supplier, however, has an undeniable advantage: it is willing to sell weaponry that Western states would deny to the Arab Gulf states. In a show of independence in the 1980s, Saudi Arabia acquired ballistic missiles from China as a warning to Washington that the Saudis can satisfy their defense needs elsewhere. Yet, because the integration of defense systems as part of the U.S. security umbrella requires technology from the United States and other Western powers, China is unlikely to emerge as a major arms supplier in the medium term.

In addition, China's expected entry into the Gulf has already created concerns among other Asian nations wary of Chinese influence. In particular, India is keen to prevent China from becoming a major naval power in the Indian Ocean for fear of strategic encirclement. This rivalry may play out in the Gulf, where Indian influence and power have been felt for centuries. Another rivalry that could unfold in the Gulf would be between the United States and China.

CHINA, IRAN, AND THE ARAB GULF STATES

For the Arab Gulf states, Iran's regional ambitions and nuclear program pose the most pressing challenge to the region's stability. Though silent, the Arab Gulf states remain supportive of the Western strategy to pressure Iran through sanctions, proclaiming adherence to any UN-approved resolution imposing sanctions on Iran, more so if sanctions are adopted by a unanimous vote. They regard the legitimacy and political cover provided by the UN as essential instruments to counter accusations that they are caving in to Western will.

This means that China, a permanent UN Security Council member with a veto right, plays a key role at stopping Iran's nuclear program. Yet China has been unwilling to decisively leverage its influence on Tehran for complex reasons: energy interests; business interests; principled opposition to sanctions; distrust of U.S. objectives toward Iran; and other geopolitical calculations. In fact, resolute Chinese opposition to sanctions, which so far has not materialized, would complicate the ability of the Arab Gulf states to implement them.

The Arab Gulf states could potentially encourage a reluctant China to support stronger sanctions against Iran. They could offer guaranteed oil pricing and supplies to China to ease Beijing's concerns on the repercussions on oil prices in case a serious crisis occurs with Iran, or if an angry Iran may punish Chinese support for sanctions by restricting the supply of oil or oil concessions. Arab Gulf officials have traveled to Beijing for consultations on Iran but have never publicly admitted using oil guarantees to sway China. In reality, China has, on its own, reduced its Iranian oil imports in recent times. The fact that China has not gone beyond principled and generic statements against nuclear proliferation has made Arab Gulf elites concerned about whether Beijing takes their anxieties seriously. To prevent alienating China, however, they have refrained from making explicit statements to that effect.

ADDING TEXTURE TO THE RELATIONSHIP

A key challenge for the Arab Gulf states is to find ways to add texture to their relations with China in the coming years and enhance cultural ties. A sign that the Arab Gulf states take China seriously is the attention and investment that countries like Saudi Arabia and the UAE have dedicated to their pavilions at the Expo 2010 Shanghai. Another example is the rapid financial assistance that the UAE and Saudi Arabia have provided in the aftermath of the 2008 Sichuan earthquake (\$50 million each). The official media in the Gulf is full of praises for China and its economic achievements while Arab officials visiting China never miss any opportunity to speak in generous and admiring terms about China's progress. Saudi Arabia, Kuwait, and the UAE are encouraging their citizens to learn Mandarin and study in China.

Yet, China has yet to make inroads in the Gulf. China is still a mystery to many Gulf Arabs who are increasingly buying Chinese products yet remain estranged from Chinese culture. The presence of almost 200,000 Chinese in Dubai has not yet translated into a significant local outreach. Chinese cultural centers and activities in the Gulf are still sparse. According to the Arab Public Opinion Poll of 2009, only 9 percent of Arabs say they would want to live in China, well behind France (36 percent), Germany (24 percent), and the United Kingdom (12 percent), but ahead of the United States (5 percent) and Russia (4 percent).

THE NEW SILK ROAD, “CHINDIA,” AND THE GEO-ECONOMIC TIES THAT BIND THE MIDDLE EAST AND ASIA

Afshin Molavi

On a recent visit to the holy Muslim city of Mecca, I found myself browsing through one of the dozens of stores that sell religious bric-a-brac and souvenirs: plastic key chains with pictures of the Grand Mosque, multi-colored prayer beads, or faux golden replicas of the ka’aba (the structure at the center of the Grand Mosque). Upon closer inspection, most of these items had a familiar label on them: “Made in China.”

Though it might be surprising to think of Muslim pilgrims from around the world buying Chinese-made religious souvenirs in the Muslim world’s holiest city, it should not be so. Chinese-made goods have been a dominant feature of Middle Eastern bazaars over the past decade. The Mecca souvenirs are just the latest and perhaps, most symbolically powerful manifestation of China’s growing commercial footprint in the broader Middle East. *To wit: in 2009, China quietly surpassed the United States as the world’s largest exporter to the Middle East.* Another quiet milestone was achieved that same year—China surpassed the United States as the largest buyer of Saudi crude oil.

Long-time observers of the Middle East have taken note of several changes in the urban landscape over the past decade. There are more skyscrapers, more satellite dishes, more veils (especially in places like Egypt and Jordan), more cars (and thus, more traffic and smog), and of course, more Chinese. From five-star hotels to regional manufacturing zones, from the halls of power to the alleyways of the wholesale bazaar, “China, Inc.” is making its presence felt across the Middle East.

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And the traffic is not just one-way. According to Ben Simpendorfer, author of the first-rate book, *The New Silk Road*, the Middle East now sends more visitors (200,000 per year) to a single Chinese city, Yiwu, than they do to any part of the United States (180,000 per year). Yiwu is home to tens of thousands of wholesale retailers, the sort of shops that sell Mecca souvenirs and teddy bears and vacuum cleaners and shoes and undergarments and blenders that fill up Middle Eastern bazaars. Small- to mid-sized shop owners from Cairo to Jeddah stock up in Yiwu on business trips. And when they are not doing business, they can pray at the local mosque nearby or eat in one of the dozens of Arabic restaurants that cater to Middle Eastern clientele.

While Yiwu represents an old phenomenon—the flow of goods from China to the Middle East along the Old Silk Road, the recent initial public offering (IPO) of the Agricultural Bank of China (AgBank) represents a new phenomenon on the New Silk Road—the increasing cross-border investment and high finance interaction between the Middle East and the Middle Kingdom. The July 2010 AgBank IPO hits the record books as the largest offering in world history, topping \$23 billion. AgBank’s two largest investors, the Qatar Investment Authority at \$2.8 billion and the Kuwait Investment Authority at \$800 million, both originate from the Middle East. The previous record holder for the richest IPO in history, the Industrial and Commercial Bank of China in 2006, was also heavily oversubscribed by Middle Eastern sovereign wealth funds and individuals. Increasingly, the Gulf Cooperation Council (GCC) institutional investors see opportunities in the China growth story, and Chinese banks are benefiting from Gulf investors.

The AgBank IPO offered two historic ironies. First, a bank originally founded by Mao Zedong to cater to rural peasants suddenly became the darling of the global investment community with bankers beating a path to Beijing to get a piece of the action. Second, China’s traditional Arab world partners—the non-aligned “revolutionary” states—were nowhere to be found in the record-breaking IPO, having been replaced by China’s newer allies in the GCC region.

In addition to the trade, capital, and “merchant flows,” China and the Middle East have also witnessed a significant rise in what I call the “head of state flows.” Chinese president Hu Jintao is a regular visitor to Middle Eastern capitals, and regional leaders line up to make their pilgrimages to

China, mindful of the growing stature of their Eastern neighbor. King Abdullah of Saudi Arabia, the regional political and economic heavyweight, sent an important signal to the world shortly after he ascended to the throne in 2005: his first state visit was to Beijing.

The Saudi-China relationship is, in many ways, a meeting of giants: the oil giant meets the world's rising industrial giant. Shortly after Saudi king Abdullah visited China, Hu reciprocated in March 2006 and combined the Saudi Arabia visit with a visit to another strategically vital country—the United States. It was a clear signal: China views Saudi Arabia as a strategic partner, in the same league with the United States. While in Washington, Hu was heckled by a protestor in a minor diplomatic row on the White House lawn, Hu was feted in Riyadh with a rare honor for foreign visitors, speaking before the Saudi Majlis As-shura with all Saudi cabinet ministers and the Saudi king in attendance.

King Abdullah's second state visit to India was equally meaningful. While China is a relatively new player in the commercial life of the Middle East and the GCC states, India has deeper roots with the GCC states, especially Bahrain, Qatar, and the UAE. Indian merchants have been trading with their counterparts (who are often Indian) in the UAE and Bahrain for hundreds of years. Until the late 1960s, the mode of currency in Bahrain and the UAE was the Indian rupee. The first post office on the Arab side of the Persian Gulf, formerly a sub-office of the British India mail service, was in Bahrain. And for several decades in the contemporary era, Indian laborers have built the skyscrapers, manned the service jobs, and staffed the private sector bureaucracies in virtually all of the GCC states.

For India, the relationship is vital. India sources most of its petroleum imports from the GCC states. After the United States, the GCC states are India's most important trade partner. A recent study conducted by the Dubai Chamber of Commerce and Industry noted that India and the GCC states conduct some \$90 billion of trade annually. Remittances from Indian laborers in the GCC states contribute meaningfully to India's national economic growth. In an interesting twist of pop culture interaction, Bollywood holds its annual "Oscars" not in Mumbai but in Dubai. The deep Indian imprint on the UAE is perhaps why some Indian expatriates joke that "the best city in India is Dubai."

Yet the king of Saudi Arabia visited India not because of the Indian laborers (whose contribution to Gulf state development was never properly

acknowledged by a single GCC leader) nor because of the historical ties to the lower Persian Gulf, but due to one reason alone: the rise of the Indian economy and its future demand for the Gulf region's most important commodity, oil.

The GCC-India and GCC-China relationships will be vital to the futures of all sides, and ultimately, this New Silk Road is paved with petroleum. Since 2006, Asia has been the largest trading partner of the GCC states, accounting for some 55 percent of the GCC's total trade, the vast majority of GCC exports comprised of hydrocarbons. According to McKinsey & Company, trade flows between China and the GCC will climb to between \$350 billion and \$500 billion by 2020, more than three times the current amounts with mostly oil and gas exports from the GCC side.

More specifically, China and India represent the single most important drivers for future energy demand growth in the world. With a combined population of 2.5 billion and expected average growth rates to be the highest in the world through 2030, it should come as no surprise that "Chindia" will account for more than a quarter of world energy consumption by 2030 (28 percent, according to the U.S. Energy Information Administration). In contrast, the U.S. share of world energy consumption will fall from about 21 percent in 2006 to 17 percent in 2030.

Clearly, the oil-rich GCC states see India and even more so, China, as their most important markets for the future. In fact, Saudi Aramco CEO Khalid Al-Falih went further to say that "China is actually contributing to global energy security because its rising demand encourages and sustains those vital investments" needed to increase production in producer countries. In short, China is not only a strategic partner for Saudi Arabia, but also a vital ally to oil producers worldwide.

If we look at "Chindia" as a single energy entity, we see a powerful energy consumer. Chindia's oil consumption and oil imports rank it second in the world, after the United States. Its natural gas consumption ranks it third, after the United States and Russia. Clearly, every major oil producer is fashioning a China and India strategy for the future.

China's dependence on foreign oil imports began in 1993. Before that time, China was largely self-sufficient in oil. Today, China consumes more than 8 million barrels per day (b/d) of oil, which could double to 16 million b/d over the next two decades. With domestic production peaking

at about 4 million b/d, the simple math of China's energy future will tie it ever more closely to the region with the world's largest petroleum reserves.

I often like to compare China's energy consumption to one of its national treasures, the panda. Just as the panda must eat bamboo 16 to 18 hours a day to survive, China Inc. needs to consume or "eat" energy (in the forms of oil, gas, coal, hydro, etc.) seemingly 24 hours a day to maintain high growth rates and keep up with its rising middle class.

The China "energy panda" has many partners. While China sources some 50 percent of its imports from the Middle East, its import portfolio is more diversified than many of its Asian neighbors. Still, China will increasingly rely on Middle Eastern producers over the next two decades.

Where do most Chinese imports come from? A glance at the May 2010 list of top suppliers to China offers a good sample and illustrates a few key trends. The top ten suppliers to China in May 2010 were:

- Saudi Arabia (886,000 b/d)
- Angola (751,000 b/d)
- Oman (383,000 b/d)
- Russia (372,000 b/d)
- Brazil (221,000 b/d)
- Kazakhstan (194,000 b/d)
- Sudan (190,000 b/d)
- Iran (189,000 b/d)
- Kuwait (141,000 b/d)
- Congo (125,000 b/d)
- Others (766,000 b/d)

Saudi Arabia and Angola are usually at the top of the list of China's suppliers, alternating at the number one slot. In the first five months of 2010, Angola's exports to China slightly exceeded those from Saudi Arabia. Meanwhile, China's refinery expansion is focusing more on sour and high sulfur crude oils, which characterize many Middle Eastern grades.

In April 2010, China with total imports exceeding 5 million b/d broke its own oil import record. Thus, all its major suppliers, except Iran, saw an increase in their exports. Despite China's growing demand for oil imports, its purchases of Iranian crude in the first quarter of 2010 was down 35 percent. For the first five months of 2010, China's intake of oil from Iran

averaged 193,000 b/d whereas its intake averaged 354,000 b/d during the first five months of 2009.

If we look at May 2009 figures, Iran was China's number one supplier for that month with more than 700,000 b/d supplied. Its fall to eighth place in May 2010 with a decline to less than 200,000 b/d should catch the eye of Iran-China relations watchers. Taking a one-month snapshot may not be useful in the long term, but sufficient data is now available suggesting that China's intake of Iranian crude will likely decline substantially in 2010.

The decline in Chinese imports from Iran along with the concomitant rise in imports from almost all its other sources has led some oil industry watchers to ask if China is lowering its Iranian intake for strategic reasons, or is it a mere pricing issue. More data is required to answer that question, but it is worth noting that Iran has lost market shares in India and Japan in the first half of 2010, and Japanese refiners have complained that Iran's crude is overpriced. Therefore, the decline in Iranian exports is taking place in an environment where Iran is storing large amounts of crude offshore, idling in tankers.

There is much speculation in Washington and in the media about the China-Iran relationship. The knee-jerk assumption tends to be that China views Iran as a strategic partner and it will therefore defy any attempt to isolate Iran in the United Nations Security Council and in the international community. While Beijing has indeed watered down several Security Council resolutions against Iran, a closer look at the hydrocarbons relationship reveals a weakness in the "China-views-Iran-as-a-strategic-partner" argument. In short, Iran needs China far more than China needs Iran, and Beijing has subtly demonstrated that it considers Iran as merely one of dozens of partners it interacts with in a mercantilist fashion, more so than a key strategic energy ally for the immediate term. Iranian president Mahmoud Ahmadinejad voiced this concern after both China and Russia voted once again for a fourth round of sanctions on Iran in the Security Council, when he said: "Are these countries friends and neighbors? Are they with us or looking for something else?"

The raft of sanctions aimed at Iran, including those from the United Nations Security Council, the more recent ones from the European Union, and unilateral ones from the United States, has left Iran's oil and gas industry in dire straits. It is estimated that Iran has an annual decline rate of 8 to 11 percent in its oil fields. Iran's oil minister Masood Mirkazemi

estimates that Iran needs some \$25 billion a year in investments to stem a decline in production, which currently hovers at a weak 3.5 to 3.7 million b/d (less than two-thirds of Iran's pre-revolution levels of 6 million b/d, and far behind Tehran's targets for 5 million b/d by 2010). In the current environment in which not a single major European company is willing to invest in Iran's upstream, there is virtually little chance that Iran will come even close to that level of investment.

Enter China. Iran's most significant potential new production is centered around the three fields of North Azadegan, South Azadegan, and Yadavaran of which, two Chinese firms, CNPC and Sinopec, retain majority stakes. While work is progressing, industry observers note that CNPC and Sinopec have been slow to ramp up their work and Iranian oil officials quietly grumble about the slow pace. Iran's most important gas project, the South Pars field, is also beholden to CNPC, which has yet to demonstrate any signs of progress. While Ahmadinejad will continue to thump his chest and declare that Iran's industry can survive without foreign partners, it will certainly not thrive and could be headed for a steady decline. Even Iran's steadiest European partner, ENI of Italy, has declared its intent to depart the country after nearly 50 years of cooperation.

Thus, in Iran's oil and gas industries, Iran's future is overly dependent on Chinese firms as European majors step aside. This is perhaps why evidently the Iran-China relationship is indeed strategic and vital for Iran, but not necessarily for China.

By contrast, Beijing seems to view Riyadh as its main Middle Eastern strategic energy partner for the future. Saudi oil accounts for 20 percent of Chinese imports and Chinese refineries are increasingly configured for Saudi crudes. Saudi Aramco holds a 25 percent stake in an 80,000 b/d refinery in Fujian in a joint venture with Exxon Mobil and Sinopec, and China seems eager to further enmesh Saudi Aramco in its refinery future. China has also been in talks with Saudi Arabia about forming the base of a Strategic Petroleum Reserve (SPR). Meanwhile, talks are ongoing for Aramco to take another 25 percent stake in a refinery in eastern China's Shandong province. Saudi Arabian Basic Industries, the petrochemicals giant, operates a petrochemical complex in Tianjin in a 50-50 joint venture with Sinopec and plans to carry out another venture in Dalian.

Perhaps the most interesting contrast between the way Beijing views Tehran and Riyadh lies in the "head of state" flows. The well-traveled

Hu Jintao has visited Riyadh twice in the past five years, while he has yet to set foot in Tehran.

Of course, this is not to suggest that Beijing is interested in discarding Iran as an energy partner. After all, as an “energy panda,” China is not in a position to discard anyone, let alone a major player like Iran. Beijing, however, has clearly signaled that it lends more weight to Saudi Arabia than to Iran, and its foot-dragging on investments in Iran continues to sour the relationship.

This is not surprising given Riyadh’s heavyweight status in the oil world. What might be more surprising is Beijing’s seemingly tilt toward Iraq, away from Iran, in its outward investments. In many ways, China has been an unlikely winner of the U.S.-led invasion to overthrow Saddam Hussein. Chinese companies have won three of the 11 major oil contracts offered by Iraq’s oil ministry, including development of the giant Rumaila field in a joint CNPC-BP alliance. China also has an independent contract in the oil-rich Kurdish region in northern Iraq. The CNPC-BP partnership on the supergiant Rumaila field aims to raise its current production from 1.1 million b/d to 2.85 million b/d within seven years, at a cost of some \$15 billion. If Iraq even comes close to this goal, it will clearly emerge as one of CNPC’s biggest prizes. It is also important to remember that CNPC has assets in 29 countries. While Iran likes to tout its partnership with CNPC as an example of the futility of sanctions, CNPC senior managers have a more global outlook. The “energy panda,” after all, eats from a wide variety of sources.

Thus far, China has demonstrated a greater willingness to pursue its projects in Iraq with resolve and speed over its Iranian ventures. First, China’s projects in Iraq have the benefit of the international community’s “green light” bearing no threats from U.S. congressional resolutions, U.S. Treasury arm-twisting, or U.S. state pension funds (of divestment from Chinese companies, as is the case with their Iranian investments). Second, China’s investments in Iraq are also in partnership with other major international oil companies (IOCs) that will lend both capital and expertise. By contrast, its projects in Iran are stand-alone or with Iranian partners. Lastly, while Iraq poses several security challenges, the clouds of uncertainty hanging over Iran are darker, mostly due to the external unpredictability of a potential Israeli and/or U.S. military strike on Iran’s nuclear facilities. As Samuel Ciszuk of IHS Global Insight put it: “Iraq is

extremely important for Chinese companies' growth strategy, especially given that Iran is likely to face much of a standstill for years." Or as one oil industry executive commented on investments in Iran: "Always at the uppermost of your mind is this basic question: is this investment worth the headache?" Chinese oil companies will likely see Iraq as less of a "headache" than Iran.

As for Indian oil and gas companies that have also closely looked at the Iranian market in the past few years, they also seem to be circling back, wondering if the "headache" is worthwhile especially given their increasing presence in the United States and the sanctions that may arise from their Iranian investments. So while the New Silk Road is alive and well, Iran's controversial nuclear program seems to put it in a laggard position as China, India, and other Asian players link strategically with partners in the GCC states, fearful of the repercussions of heavy involvement with Iran.

This much-touted New Silk Road also requires us to think anew the geography of the Middle East and Asia. After all, we are, in a sense, simply talking about the growing links between West Asia (i.e., the Middle East) and East Asia. When the Saudi king visited China and India, it represented a West Asian head of state meeting his East Asian and South Asian counterparts. The flight from Dubai to Mumbai is shorter than that from Dubai to Cairo. And the host of the 2008 Asian Games was the West Asian city of Doha, in Qatar. With hundreds of weekly flights from West Asia to East Asia, these two regions are only coming closer together.

U.S. policymakers should welcome the growing West Asia-East Asia geo-commercial and geo-economic ties as an important lever driving global growth, lifting part of the heavy burden from the United States. Meanwhile, as China and India grow more reliant on Middle Eastern oil, they will not look kindly upon any attempts to disrupt that oil flow. While neither Beijing nor Delhi will replace Washington's role in maintaining Gulf security, both capitals agree with the basic premise of U.S. policy: the importance of free-flowing Persian Gulf oil.

Thus, this West Asia-East Asia economic corridor will not only shape the future of both regions, but can strengthen regional stability, and contribute to global growth. In much the same way that the Old Silk Road converged culture and commerce, this New Silk Road has brought West and East Asia closer together, drawing a new commercial geography of the Middle East and Asia.

CHINA AND THE GULF IN 2010: A POLITICAL ECONOMIC SURVEY

Jean-François Seznec

INTRODUCTION

It seems to be common, accepted knowledge in the United States, especially in Washington, that China is very opportunistic and willing to sacrifice any political morality to gain access to energy sources. Various nongovernmental organizations (NGOs) and their supporters in the U.S. Congress have heavily criticized China for backing the Sudanese government in the aftermath of the genocide in Darfur, allegedly in exchange for the 219,000 barrels per day (b/d)¹ that it receives from Sudan's oil fields. Based on recent reports of numerous new contracts set up between the Chinese government, (mainly state-owned) Chinese companies and Iran for the exploration and exploitation of large Iranian oil fields, China's Iran policy is generating criticism from various groups including supporters of Israel's Likud party, Iranian émigrés, and antiwar groups opposed to potential U.S. military attacks on Iran. They criticize China for dealing with the ayatollahs in spite of the latter's violation of human rights or posing existential threats to Israel. China is also reportedly considering to invest in Iran's natural gas and liquefied natural gas (LNG) plants that would replace Western companies that left Iran under governmental pressure (as in the case of France's Total). In many people's minds, China's approach to international politics, even as it works against American values and interests, is purely mercantilist.

Considering the actual facts on the ground, the overall picture is not as clear-cut. China's extensive relations with Iran today are mostly based on talk with little action. In fact, China's overall trade with Iran is relatively limited compared to that with Saudi Arabia. (Sino-Saudi trade is three times the size of Sino-Iranian trade.) Also, most Chinese investments in

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Iran are paper promises. So far, only two sizable investments have actually been made in two of Iran's oil fields, which have yet to yield any crude. If they produce oil, the increase would be about 115,000 barrels per day (b/d),² hardly a major change to Iran's 3.8 million b/d overall production.

In essence, it seems that China is "amusing" Iran. China wants to be Iran's sole patron but without committing full support, in order to avoid upsetting its more essential ties with other Gulf countries or the United States. Certainly, China's need for energy is of primary importance, so like all buyers of energy, China will mainly deal with reliable suppliers and in turn, diversify its energy sources. In other words, China will maintain dealings with Iran in order to keep the supply lanes open, while at the same time, lean on Saudi Arabia to serve as the primary supplier of crude oil and chemicals in the Gulf and as a principal market for Chinese products.

CHINA AND THE GULF OIL TRADE

Iran

In 2009, China bought 462,000 b/d of crude oil from Iran, up from 425,000 b/d in 2008. This amount looks like an increase but that may not be the case. Although China increased its overall imports of Iranian crude in 2009 from 3.577 million b/d to 4.061 million b/d corresponding to a rise in market share for Iran of respectively 11.3 percent to 11.8 percent,³ this amount is insignificant and shows a decline from its 12.5 percent market share in 2007. According to Reuters, Iranian sales of crude to China in January and February 2010 dropped by 37.2 percent,⁴ with no substantial increase in March and April. This decline, a market share of 6.8 percent, suggests that China is reducing its reliance on Iran. The total Sino-Iranian trade in 2009 which is around \$21 billion,⁵ including about \$10 billion for oil is low and minute compared to the overall Chinese trade with the United States. In fact, this amount is approximately equivalent to the two months balance of the U.S. trade deficit with China,⁶ further underscoring the fact that for China, Iran is of little consequence, not worth antagonizing China's major trade partners.

In the near past, China has sold gasoline to Iran but the trade is insignificant compared to the 130,000 b/d imported by Iran in 2010.⁷ A

Chinese company reportedly sold 600,000 barrels for \$55 million (\$92 per barrel). Buying gasoline from China is not economical for Iranian gasoline imports as the cost of transporting light products from the Far East to Iran is exceedingly expensive. Also, oil dealers aware of Iran's despondency for gasoline tend to charge hefty profit margins on such sales. U.S. sanctions that could impact Chinese firms will further put a damper on these sales, while closer, more traditional suppliers of gasoline to Iran, like India's Reliance Industries Limited, have said that they would stop this trade.

Nonetheless, China is still developing some of Iran's oil fields. China National Petroleum Corporation (CNPC) is working in South Azerdegan to increase production by 120,000 b/d. Also, China Petroleum & Chemical Corporation (Sinopec) plans to invest \$2 billion to develop the Yadvaran field. These ongoing ventures have yet to yield new oil.

Saudi Arabia

Unlike the Sino-Iranian trade, trade relations between Saudi Arabia and China have increased dramatically. Saudi Arabia is the largest supplier of crude oil to China. Saudi crude oil exports to China has steadily risen from 2007 to January 2010: in 2007, Saudi Arabia was selling 528,000 b/d, in 2008, 574,000 b/d, in 2009, 845,000 b/d, and was reported to have sold over 1 million b/d in January 2010. Although, since then, imports have declined slightly in the subsequent four months, Saudi Arabia is still the largest supplier of crude to China, in competition with Angola. Saudi Arabia's market share has increased from 17 percent of China's crude oil imports in 2005 to more than 21 percent in 2010.⁸

China prefers Saudi Arabia as an energy partner over Iran mainly because China values the reliability of supply. However, this may also have to do with the politics of Sino-U.S. relations and trade. Seeing that the Iranians are isolated and have poorly managed oil fields and declining oil production, the Chinese are at ease with Saudi Aramco, one of the most reliable crude oil suppliers in the world.⁹

Overall, the Sino-Saudi relationship strengthened through the support of both governments is deepening and growing. Sino-Saudi negotiations are fundamentally based on economic interests, not fraught with political and ideological baggage. From China's perspective, the relationship is mutually beneficial. It buys from Saudi Arabia and has invested in joint

ventures with Saudi Aramco in the Gas Initiative while Saudi Aramco has invested in a 200,000 b/d refinery and petrochemical complex in Fujian province with ExxonMobil and Sinopec. Saudi Aramco is also negotiating for another refinery on a 50–50 basis in Qingdao. Last but not least, Saudi Basic Industries Corporation (SABIC), the large state-owned Saudi chemical company, has just started operating a major chemical complex in Tianjin.

Iraq

Bereft of investments and maintenance, Iraq has opened its oil fields to foreign oil companies for upstream investment as a means to substantially increase production and revenue. Most international oil companies—including the Chinese—have actively bidden on Iraq’s oil fields, albeit in joint venture with other firms equipped with more knowledge and familiarity of the local fields. CNPC joined British Petroleum in a winning bid to increase production of the Rumaila field, the oldest and largest in Iraq, to 2.85 million b/d from the present 1.85 million b/d. In association with Petronas and Total, CNPC also won the bid for the Halfaya field to reach a production level of 535,000 b/d. Finally, Sinopec with a 20 percent interest with ENI, Oxy, and Kogas won the bid for increasing capacity of the Zubair field to 1.125 million b/d. Upon completion, these bids could potentially increase China’s access to almost 1.9 million b/d,¹⁰ turning Iraq into China’s largest supplier of crude oil by 2020.

CHINA AND THE NATURAL GAS TRADE

With the second largest gas reserves in the world, Iran is not exporting natural gas to China but is, in fact, a net importer of natural gas from Turkmenistan. It does, however, export modest amounts of gas to Turkey, but less than how much it imports. The only way Iran can export natural gas to the Far East is by transforming its large reserves of methane gas to LNG, emulating what Qatar is presently doing. However, LNG requires extensive access to technology and capital, neither of which Iran has. Iranian media reports indicate that Iran has signed memorandums of understanding (MOUs) with Chinese firms to explore various gas fields,

specifically the South Pars offshore field contiguous to the North Dome of Qatar.

CNPC, in replacing Total of France, is investing \$4.7 billion on Phase 11—drilling in South Pars. The gas would be piped under the Gulf to a terminal on Iran's coast for conversion into LNG. CNPC will also in principle develop Phase 14 together with another LNG plant for a total of \$3.6 billion. China National Offshore Oil Corporation (CNOOC) is in talks with Iran to spend \$16 billion on the South Pars field and build another LNG plant on the coast.

In the last two years, the pricing of natural gas has, by and large, decoupled from the price of oil. In the past, natural gas prices were mostly linked to oil as utilities (the main users of gas) would switch to oil products if gas prices rose. Moreover, the global demand for gas has tremendously increased in line with the shift toward gas by utilities providing cleaner and more efficient energy generation, while gas prices on the New York Mercantile Exchange (NYMEX) dropped to \$4 per million British thermal unit (Mbtu). As such, most long-term contracts for transporting LNG to Asia from the Gulf are based on a formula linked to oil parity. In general, with oil at \$70 per barrel, gas would be priced at \$11/MBtu. However, with the development of LNG facilities worldwide and Qatar bringing an additional 44 million tons per year (ts/y) of LNG to a global total of 77 million ts/y, there is an excess supply of LNG. In addition, technological developments in the United States in the production of shale gas render most LNG exports to the United States unprofitable as U.S. gas prices are likely to remain at \$4/MBtu, below the breakeven rate for LNG from the Middle East. Hence, extra LNG is very likely to be sold in Asia at prices equivalent to that in the United States. So, for China, rather than invest more than \$24 billion in Iran, it could easily buy natural gas for less than half the current prices in Asia from Qatar and Australia (in the near future). Also, China could gain access to these places without mobilizing huge amounts of capital or antagonizing its major trade partners. Therefore, in the foreseeable future, it is very unlikely that Iran will see any real development of its gas industry with Chinese capital and know-how.

OTHER NON-OIL TRADE

Iran

China's non-oil trade with Iran, consisting mostly of sales of Chinese goods to Iran and minimal non-oil sales from Iran to China, totaled only \$11 billion in 2009.¹¹ This is counterintuitive as Iran is seeking to be the second largest manufacturer of chemicals in the Middle East, behind Saudi Arabia. Although Iran keeps announcing new ethylene plants coming onstream and large downstream production facilities to produce millions of tons of various products, there is little sign of Iranian chemicals sold outside of Iran. Most chemicals in the Middle East, mainly methane and ethane, are based on natural gas. Therefore, Iran, with the second largest gas reserves in the world, should have been at the forefront of the industry. However, Iran is incapable of maintaining, let alone, developing its fields. A large amount of gas would need to be reinjected into the oil fields to maintain pressure, thereby limiting the downward trend in oil production, and taking gas away from industrial development and electricity generation. Iran would require large amounts of capital and technology to provide sufficient gas to its chemical industry. Hence, many of the newly-built large plants that work at about a 50-percent capacity are insufficient to provide for an industry which demands an over 90-percent capacity to make money.

Saudi Arabia

In contrast to Iran's inability to export value-added productions from its energy supplies, Saudi Arabia has emerged as the fifth largest producer of chemicals (including fertilizers based on methane) in the world. In 2009, Saudi Arabia exported about \$28 billion worth of goods, mostly chemicals and fertilizers, to China.¹² China, for its part, exported to the Kingdom \$12.6 billion in 2009, mostly consumer goods, clothes, etc. Hence, the total trade between China and Saudi Arabia in 2009 stood at about \$60 billion, including an estimated \$20 billion from oil sales to China. The total trade between China and Saudi Arabia is thus three times the amount of the Sino-Iranian bilateral trade.

CONCLUSION

China's decline in oil purchases from Iran as well as the skyrocketing trade between Saudi Arabia and China indicates that China is forging stronger economic ties with Saudi Arabia, not Iran. However, China still maintains some links to Iran apparently seeking to "amuse" Iran by signing large amounts of MOUs while working actively to do very little on the ground. In this sense, China may be, of course, reacting to U.S. pressure to limit links with a member of the "axis of evil," but more likely, China is probably tired of negotiating with Iran, convinced that the ultimate reliability of supply is with Saudi Arabia.

Any military conflict with Iran could precipitate the potential destruction of expensive Chinese industrial assets in Iran similar to Japanese Mitsubishi's loss of a \$1 billion investment to Iraqi bombs during the Iran-Iraq war. Furthermore, the present regime in Iran is notoriously difficult to negotiate with. A Saudi official mentioned that negotiating with Iran is based on the premise that "mine is mine (i.e., Iranian), what's yours is negotiable." The Chinese are well aware that deals in Iran are constantly renegotiated. Moreover, Iran is now very isolated, especially since the latest vote at the United Nations (UN) on sanctions. Iran is no longer in a good bargaining position, putting it in a highly precarious situation in international trade. China is perfectly willing to take full advantage of its position and get the very best terms from Iran, which Iran is not willing to give for nationalistic reasons, bringing trade to a minimum. Hence, Saudi Arabia and its very professional technocrats at Saudi Aramco, SABIC, and various ministries appear to provide China with a long-term reliable partner and supplier, and benefit from Iran's problems.

Other states of the Gulf Cooperation Council (GCC), along with the Saudis, are keen to further develop relations with China. In spite of being heavily indebted to U.S. military power for protection, GCC member states that are distressed by U.S. policies in Palestine and Iraq and fearful of adventurism in Iran are throwing their economic hat with the new economic hegemon in Asia. Thus, China, in establishing booming economic links with the GCC, in particular with Saudi Arabia, fulfill a two-fold strategy. The first part of this strategy aims to contain Iran. The second part is to contain the U.S. influence on Arabs in the Persian Gulf. China's growth into an economic behemoth could eventually limit U.S.

military power and ideology in the region. Perhaps, a new paradigm of international relations is gradually emerging in which, ultimately, economic might trumps military might in the Gulf.

ENDNOTES

1 U.S. Energy Information Administration (EIA), "Country Analysis Briefs: China," November 2010, database available from <http://www.eia.doe.gov/cabs/China/oil.html>.

2 EIA, "Country Analysis Briefs: Iran," January 2010, database available from <http://www.eia.doe.gov/cabs/Iran/Oil.html>.

3 Joint Oil Data Initiative (JODI), "JODI Database, 2010," database available from http://www.jodidb.org/ReportFolders/reportFolders.aspx?sCS_referer=&sCS_ChosenLang=en.

4 Reuters, "Factbox: Ties binding China and Iran," April 2, 2010. <http://www.reuters.com/assets/print?aid=USTRE6310AW20100402>.

5 Ibid.

6 U.S. Census Bureau, "Foreign Trade Statistics: Trade in Goods (Imports, Exports and Trade Balance) with China," 2009, database available from <http://www.census.gov/foreign-trade/balance/c5700.html#2009>.

7 JODI, "JODI Database, 2010."

8 The 2005 share was computed from a report that appeared on April 24, 2006 in the *People's Daily Online* and the "JODI Database."

9 The total imports of Saudi oil by China thus amounted to about \$20 billion in 2009 (assuming a net average price of \$65 per barrel). This assumes 845,000 b/d and that China buys a mix of light crudes which sell at a premium at world prices and heavy crude which sells at a substantial discount.

10 This is computed by taking 49 percent of the interest in Rumaila's 2.85 million b/d, 50 percent of the 535,000 b/d of Halfaya, and 20 percent of the 1.125 million b/d of Zubair.

11 Computed by taking out \$10 billion of estimated oil exports from the overall trade figure of \$21 billion mentioned in Babak Dehghanpisheh, "China Races to Secure Middle East Oil Deals," *Newsweek*, May 13, 2010.

12 The Kingdom of Saudi Arabia Ministry of Finance, "Statistical Data: Kingdom's Exports to its Major Trading Partners," database available from <http://www.mof.gov.sa/en/docs/stats/index.htm>. The 2009 figure for China (SR 104.955 billion = \$27,988) does not include oil.

CHINA-GULF ENERGY RELATIONS

Erica Downs

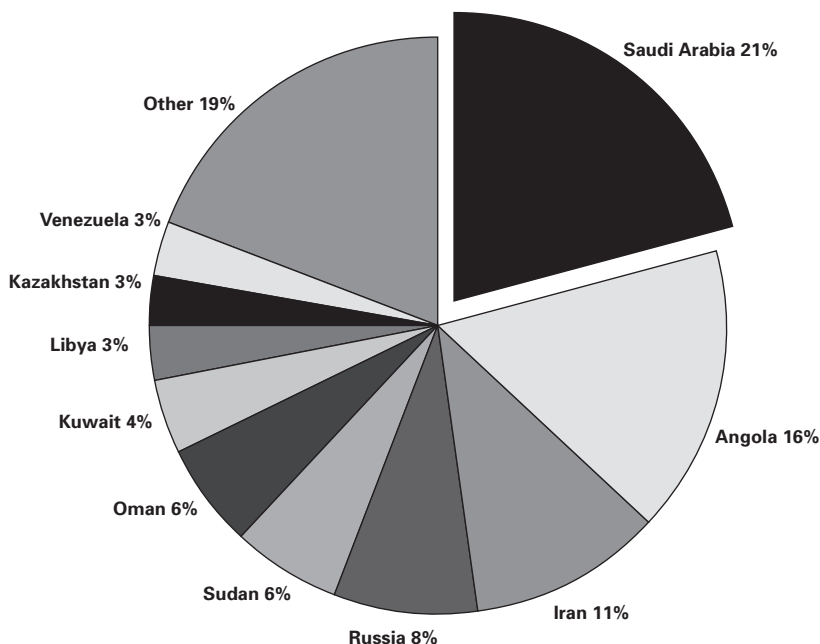
Energy, especially oil, lies at the heart of China's relationships with Persian Gulf countries. As China's oil demand and imports have grown, so have China's trade and investment ties with the states of the Persian Gulf. However, the nature of China's energy relationships with major powers in the region varies dramatically. While Chinese officials and oil executives regard Saudi Arabia as a very reliable oil supplier and Iraq as a land of tremendous upstream opportunities, Iran is viewed as a tempting but tough place to do business. The new unilateral international sanctions imposed on Iran by the United States, the European Union, and other countries are likely to reinforce these perceptions.

SAUDI ARABIA: A VERY RELIABLE PARTNER

China regards Saudi Arabia as a very reliable supplier of crude oil. Over the past decade, the Saudis have repeatedly told the Chinese that they can count on Saudi Arabia to provide China with the oil it needs for continued economic growth. They have also matched their words with deeds. Saudi Arabia has been China's largest supplier of crude oil since 2002, providing China with one-fifth of its crude oil imports in 2009 (Figure 1).

Perhaps the greatest reassurance the Chinese have received from the Saudis about their reliability as an oil supplier came during President Hu Jintao's state visit in February 2009. While Hu was in Riyadh, the Saudis promised to guarantee the supply of crude oil to China at all times as part of a "gentleman's agreement" between Saudi Aramco and China Petrochemical Corporation (Sinopec).¹ Nine months later, Ali Al-Naimi, Saudi Arabia's Minister of Petroleum and Mineral Resources repeated this pledge in Beijing in his acceptance speech for the honorary doctoral degree

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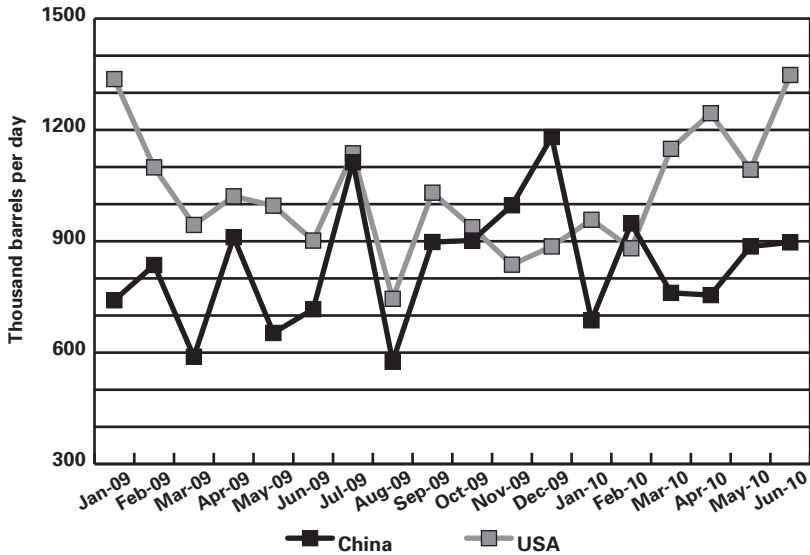
Figure 1: China's Crude Oil Imports by Supplier, 2009*Total = 4.1 million barrels per day*

Source: "China Dec crude oil imports and exports," Reuters, January 21, 2010.

awarded to him by Peking University. Speaking about Saudi Arabia's commitment to global market stability and supply continuity and reliability, he said, "let me be as explicit as possible: China can rely on Saudi Arabia to provide it with the oil it will need to continue its projected growth for the coming decades."²

Saudi promises to provide China with security of supply have been accompanied by a substantial increase in crude oil deliveries to China over the past decade. Saudi Arabia's oil exports to China grew from just 50,000 barrels per day (b/d) in 1999 to 841,000 b/d in 2009.³ Moreover, China overtook the United States to become Saudi Arabia's largest crude oil customer in November 2009. The following month, Saudi Arabia's crude oil exports to China exceeded 1 million b/d for the first time (Figure 2). This was an important milestone because Saudi Aramco had signed a

Figure 2: Saudi Arabia's Crude Oil Exports to China and the United States, January 2009—June 2010



Source: United States Energy Information Administration and Chinese customs data reported in Reuters and Dow Jones.

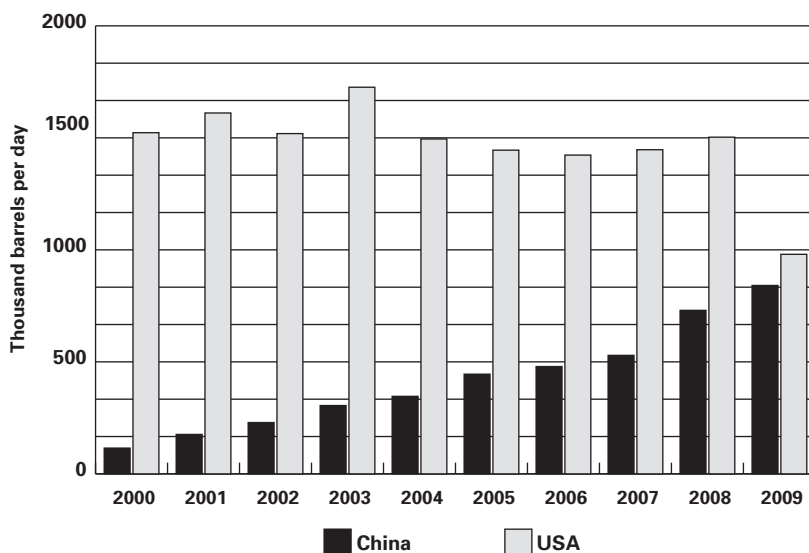
memorandum of understanding with Sinopec in 2006 pledging to increase its crude oil deliveries to China to 1 million b/d by 2010.⁴

China’s emergence as a challenger to the United States for the position of Saudi Arabia’s largest oil customer reflects the changing geography of oil. The International Energy Agency projects that over the next two decades all growth in world oil demand will come from non-OECD countries, while OECD demand will fall.⁵ China’s oil demand is expected to increase from 7.7 million b/d in 2008 to 16.3 million b/d in 2030, accounting for 42 percent of the increase in world oil demand.⁶ In contrast, oil demand in the United States, long the top buyer of Saudi crude, is expected to fall from 18.5 million b/d to 17.2 million b/d.⁷ As a result, Saudi Arabia is increasingly “looking east” for security of demand. According to Khalid al-Falih, the president and chief executive of Saudi Aramco, “Demographic

and economic trends are making it clear—the writing is on the wall. China is the growth market for petroleum.”⁸ Indeed, as Saudi Arabia’s crude oil exports to China have surged over the past decade, its crude oil sales to the United States have declined (Figure 3).

Riyadh’s pursuit of greater energy cooperation with China is not only aimed at enhancing Saudi Arabia’s energy security but also at broadening Saudi Arabia’s relationships with major powers beyond the United States. Saudi Arabia’s cultivation of closer relations with China and other rising powers since the mid-1990s has been partly driven by domestic criticism of Riyadh’s close relationship with Washington and increased tensions in U.S.-Saudi relations after the September 11 attacks, including over Washington’s push for political and religious reforms in Saudi Arabia.⁹ Riyadh, however, also wants to be part of an “Asian Century” created in large part by China’s reemergence as a global power.¹⁰

Figure 3: Saudi Arabia's Crude Oil Exports to China and the United States, 2000—2009



Source: United States Energy Information Administration and Chinese Customs Data reported in Reuters and Dow Jones.

Riyadh's efforts to persuade Beijing that it will help meet China's long-term oil demand appear to have worked. Ambassador Zheng Dayong, who served as China's ambassador to Saudi Arabia from 1994-1997, told the Chinese media on the eve of Hu Jintao's state visit to Saudi Arabia in 2009 that China's oil cooperation with Saudi Arabia will probably remain unchanged for fifty years. He noted that Saudi Arabia will remain a reliable supplier of crude oil to China because of the high priority both countries attach to the bilateral relationship.¹¹

IRAQ: LAND OF OPPORTUNITY

Iraq has provided China's national oil companies (NOCs)—and other resource-seeking companies—with a rare opportunity to access huge, undeveloped oil reserves. Although Iraq has 115 billion barrels of proven oil reserves, the fourth largest behind Saudi Arabia, Iran, and Venezuela, it only pumped 2.5 million b/d in 2009.¹² Baghdad, however, has ambitious plans to dramatically increase Iraq's oil production capacity within the next seven years to 12 million b/d, which would surpass that of Russia (10 million b/d) and rival that of Saudi Arabia (12.5 million b/d).¹³ Industry experts, including a former Iraqi oil minister, are skeptical of this expansion timetable.¹⁴ Not only would such a large capacity increase in such a short period of time be unprecedented, but Iraq's capacity buildup is likely to be hampered by infrastructure, security and political constraints, and shortages of skilled personnel.¹⁵ Consequently, Cambridge Energy Research Associates projects that Iraq's production capacity by 2020 will reach 6.5 million b/d, which would likely still rank as one of the world's largest.¹⁶

China's NOCs moved quickly to establish a foothold in the postwar Iraqi oil industry. China National Petroleum Corporation (CNPC) was the first foreign company to renegotiate an upstream contract signed with the regime of Saddam Hussein. In 2008, CNPC converted the production sharing contract it inked in 1997 for the development of the al-Ahdab field into a technical service agreement.¹⁷ China's NOCs also bid on all six oil fields offered in Iraq's first oil field auction in June 2009.¹⁸ CNPC and BP were the only winners, having agreed to increase production at the supergiant Rumaila field from 985,000 b/d to 2.85 million b/d—making it the world's second largest oil field in terms of production behind

Saudi Arabia's Ghawar—for a remuneration fee of just \$2 per barrel.¹⁹ The surprisingly low level of compensation accepted by CNPC and BP spurred other resource-seeking companies to settle for much lower service fees in order to secure huge production opportunities in the second Iraqi oil field auction in December 2009.²⁰ CNPC was also successful in this bidding round; the consortium it formed with France's Total and Malaysia's Petronas secured a contract to raise output at the Halfaya field from 3,100 b/d to 535,000 b/d for a remuneration fee of \$1.40 per barrel.²¹ In May 2010, China National Offshore Oil Corporation (CNOOC) and Turkey's TPAO reached an agreement with the Iraqi government to lift production at the Maysan complex of fields along Iraq's border with Iran from 100,000 b/d to 450,000 b/d for a fee of \$2.30 per barrel.²² These four technical service contracts rank Chinese firms among the oil companies that have benefitted the most from the Iraq war.²³

Indeed, the U.S. invasion of Iraq paved the way for CNPC to launch a very different kind of “war” in the Middle East. In January 2010, during a meeting between CNPC and Iraqi officials in Abu Dhabi, CNPC chairman Jiang Jiemin unveiled his plans to launch a “3+1 war of attrition” in the Middle East, the region at the center of the company's plans for upstream growth over the next decade. The “3” refers to the al-Ahdab and Halfaya fields in Iraq and the North Azadegan field in Iran, where CNPC is the operator, and the “1” refers to the Rumaila field in Iraq, where BP is the operator.²⁴ Jiang intends for the output from these fields to help CNPC achieve its goal of more than doubling its overseas production from 1.5 million barrels of oil equivalent per day in 2009 to 4 million b/d of oil equivalent in 2020.²⁵ He expects the combined production of CNPC's three projects in Iraq to peak at 1.8 million b/d.²⁶

IRAN: A TEMPTING BUT TOUGH PLACE TO DO BUSINESS

China's relationship with Iran is one of its most high-profile energy relationships because of the role energy plays in Beijing's diplomacy on the Iranian nuclear issue. Iran has been one of China's top suppliers of crude oil over the past decade, although volumes have been falling this year. Iran is even more important to China's NOCs because of its huge oil and natural

gas fields that are open to foreign investment. However, the amount of money China's oil firms have invested in the exploration and development of Iran's energy resources is probably substantially less than many headlines suggest. This is because of the difficulties of doing business in Iran, which are likely to continue as a result of tighter international sanctions.

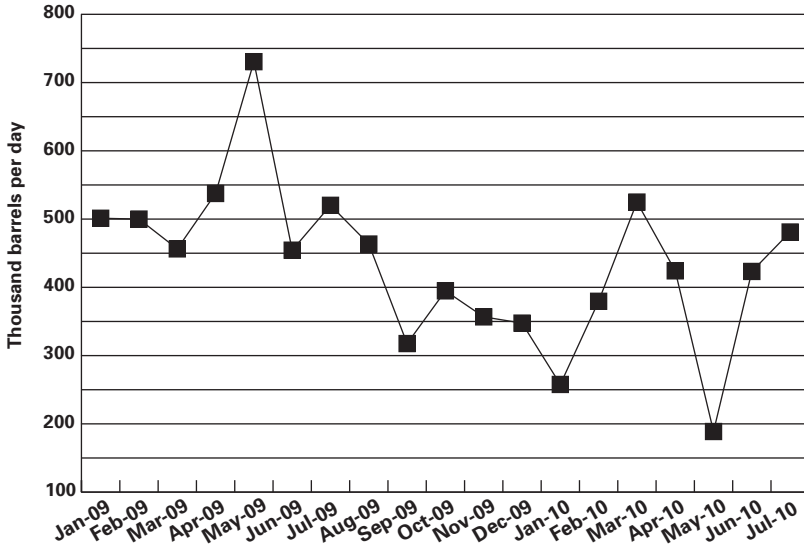
Trade

Iran is one of China's largest suppliers of crude oil. It has ranked among China's top three suppliers of crude oil every year over the past decade, with the exception of 2004 when it was number four.²⁷ In 2009, China imported 465,000 b/d of crude oil from Iran, accounting for 11.4 percent of China's crude oil imports.²⁸

Although Iran remains a leading supplier of crude oil to China, volumes have been falling in 2010. China's crude oil imports from Iran dropped by 35 percent during the first five months of 2010 before rebounding to term contract levels in June and July.²⁹ Volumes are down 28 percent for the period January-July 2010 (Figure 4).³⁰

This decline prompted speculation about whether political or commercial factors are responsible.³¹ The supposition that the reduction in Chinese oil imports from Iran may be politically motivated is partly rooted in the attempts of the Obama administration in late 2009 and early 2010 to reassure the Chinese that they would have a steady supply of oil if Iran were to cut back deliveries in retaliation for Chinese support for sanctions and to persuade the Saudis to provide such a guarantee to the Chinese.³² Both Beijing and Riyadh probably viewed Washington's efforts as unnecessary given that the Saudis had already told the Chinese that they "will always be able to purchase Saudi oil regardless of whatever changes occur in the international market."³³ While the growth in China's imports from Saudi Arabia during January-July 2010 partially offset the decline in China's crude oil imports from Iran during this period, it is likely that uncompetitive Iranian crude prices rather than a special deal with Saudi Arabia is the main reason behind the fall in Iranian exports to China.³⁴ First, Chinese oil traders and other industry analysts have indicated that higher prices for Iranian crudes prompted Sinopec, the second largest buyer of Iranian crude, to look elsewhere.³⁵ Second, there has not been the steady decline in China's crude oil imports from Iran that one might associate with a

Figure 4: China's Crude Oil Imports from Iran, January 2009—July 2010



Sources: Chinese customs data reported in Dow Jones, Platts, and Reuters.

political decision to buy less. Sinopec and Zhuhai Zhenrong have term contracts to lift a combined 440,000 b/d of Iranian crude, and China's imports from Iran were around this level for four of the first seven months of 2010, including 481,076 b/d in July (Figure 4).³⁶

China's gasoline sales to Iran have also made headlines as many of Iran's long-standing suppliers stopped selling to Iran in anticipation of tighter U.S. and EU sanctions. Although Iran is the world's fourth largest oil producer, it imports 25 to 40 percent of its gasoline (volumes vary seasonally) because of insufficient refining capacity.³⁷ Chinese oil traders Zhuhai Zhenrong, Unipec, and Chinaoil have stepped in to fill the void left by firms such as Royal Dutch/Shell, BP, India's Reliance and the Swiss trio of Glencore, Trafigura, and Vitol. Press reports indicate that Chinese firms may be supplying Iran with half of its gasoline imports, most of which is probably shipped from terminal in the United Arab Emirates.³⁸

It is likely that a primary motivation behind these sales is profits; Turkish statistical data shows that Iran has been paying a 25 percent premium for its gasoline imports.³⁹

Investment

Even more important to Beijing than China's oil trade with Iran is the opportunity for China's NOCs to invest in huge oil and natural gas fields in Iran. China's oil majors are very serious about gaining and maintaining access to Iranian oil and natural gas reserves over the longer-term. Indeed, as discussed above, CNPC has placed Iran—and specifically the North Azadegan oil field—and Iraq at the center of its plans for upstream growth over the next decade.⁴⁰ However, the amount of money China's NOCs have actually invested in the Iranian oil sector to date is probably much less than the tens of billions of dollars some media reports say the Chinese have committed to energy projects in Iran. Many estimates of the amount of money China's NOCs have earmarked for Iranian projects include deals that have not yet been concluded but are still valuable for the Iranians to highlight for political purposes. Moreover, the progress made by China's NOCs on developing oil and natural gas fields in Iran has been hampered by protracted negotiations and tighter international sanctions.

Reading beyond the headlines

A casual observer could be forgiven for thinking that China's NOCs have already sunk more than \$100 billion in the Iranian oil patch. After all, major newspapers such as the *New York Times* and the *Washington Post* have stated that China's oil majors have committed \$120 billion to projects in Iran.⁴¹ While these articles do not offer a complete explanation of how they arrived at this number, it would not be surprising if their estimates included some agreements that have not yet been finalized. For example, the *Washington Post* article appears to have included a memorandum of understanding (MOU) signed in 2004 by Sinopec and National Iranian Oil Company (NIOC) for Sinopec to acquire a 51 percent stake in the Yadavaran oil field and the role of operator in exchange for the purchase of 25 million tons of liquefied natural gas (LNG) over 30 years.⁴² The estimated value of the deal was routinely given as \$70 billion, a large portion

of which was the cost of importing 25 million tons of LNG.⁴³ Sinopec and Iran converted their MOU for Yadavaran into a buyback agreement with an estimated cost of \$2 billion in December 2007, but a purchase and sales agreement for the LNG was not signed.⁴⁴

Iranian officials and media have contributed to the confusion over the Chinese NOCs' investments in Iran by seizing on every agreement, binding or not, between Chinese and Iranian officials and energy company executives as an opportunity to trumpet China's commitment to Iran. Even if the deal in question is unlikely to ever happen, it still pays political dividends for Tehran at home and abroad to be able to point to the agreement in question as proof that U.S.-led efforts to isolate Iran aren't working. For example, in July 2009, Iranian oil officials traveled to Beijing to invite China's NOCs to invest \$42.8 billion in the expansion of Iran's refining sector.⁴⁵ China's NOCs are unlikely to invest such a large sum of money in the expansion and construction of refineries in Iran.⁴⁶ The invitation nonetheless generated headlines that Tehran can use to bolster its claim that it can continue to develop its oil industry without help from American and European firms.

In August 2010, Iran's deputy oil minister indicated that the amount of money China's NOCs have committed to projects in Iran is much less than some media reports have claimed. According to Hossein Noqrehkar-Shirazi, China's oil majors have committed \$29 billion to upstream projects and \$10 billion to downstream projects in Iran.⁴⁷ The \$29 billion is close to the combined estimated cost—\$27 billion—of the five largest oil and natural gas development projects China's NOCs are pursuing in Iran. Given that these projects are either still being negotiated or are in the early stages of development, the amount of money already invested in them by China's NOCs is probably well below this amount. Indeed, the Chinese upstream project in Iran that is probably furthest along is the Yadavaran oil field; NIOC estimated that Sinopec's progress in developing the field was 12 percent complete in January 2010.⁴⁸

Hard bargaining

The Chinese NOCs' expansion in Iran has been slowed by the difficulties of doing business there. Despite the fact that Iran, by its calculation, needs more than \$100 billion in investment to maintain and expand its

oil production capacity, the terms it has offered foreign investors in recent years have been so unattractive that at least one industry analyst has argued that the Iranians themselves have been more effective at deterring investment in their oil sector than U.S. sanctions.⁴⁹ Moreover, the Iranians are notorious for asking foreign companies to repeatedly renegotiate “final” agreements in a bid to extract more concessions from them.

It took Sinopec and NIOC more than three years to convert their memorandum of understanding for Yadavaran into a buyback contract. One of the main stumbling blocks was the project’s rate of return. The Chinese company wanted 15 percent, while the Iranians pressured them to settle for less. The two sides eventually agreed on 14.98 percent.⁵⁰

Sanctions

Multilateral and unilateral sanctions have also hampered the ability of China’s NOCs to develop oil and natural gas fields in Iran. First, sanctions have prevented China’s NOCs from accessing the equipment, parts and technology they need for Iranian projects. For example, neither China’s NOCs nor NIOC currently have the technology to liquefy natural gas, and American and European sanctions have made it extremely difficult for them to acquire it, hampering CNOOC and CNPC’s plans to monetize production from the North and South Pars fields they are involved in developing.⁵¹ CNOOC is working to develop its own liquefaction technology for use at the North Pars field.⁵² However, it will probably take CNOOC several years to match that of the major international oil companies. Second, sanctions on Iran have increased the political risk associated with investing in the Iranian oil sector.

Although China’s NOCs may not be as risk-averse as many of their international counterparts, they apparently are still cautious about investing huge sums of money in Iran. Their approach to Iran appears to be one of “talk now, spend later.” The companies are happy to negotiate agreements for projects that would almost certainly be awarded to major international oil companies in the absence of sanctions. However, China’s NOCs do not appear to be in any rush to actually pump large sums of money into Iran. Indeed, one Chinese business publication recently characterized the Chinese NOCs investments in Iran as “much thunder, little rain,” in large part because of American sanctions.⁵³

New International Sanctions: Big Rewards and Big Risks

The new unilateral sanctions enacted by the United States, European Union, Japan, and other countries increase the rewards and the risks associated with investing in the Iranian oil industry for China's NOCs. In terms of the rewards, the new sanctions have created an opportunity for China's NOCs to dominate the Iranian upstream by preventing major international oil companies from making new energy-related investments in Iran. Robert Einhorn, Special Adviser for Arms Control and International Security of the U.S. Department of State, recently estimated that the threat of sanctions has resulted in at least \$50–60 billion in oil and natural gas projects in Iran being put on hold, creating a void that China's NOCs are undoubtedly tempted to help fill.⁵⁴ In terms of risks, the new American sanctions require the U.S. government to increase its scrutiny of Chinese energy investments in Iran.⁵⁵ The question for China's NOCs is: are they willing to gamble that if they continue to invest in Iran and Washington determines those investments to be in violation of its new Iran sanction, then Washington will grant China a “national interest” waiver in a bid to secure Beijing's cooperation on the Iranian nuclear issue instead of penalizing them?

CONCLUSION

The tighter international sanctions on Iran are likely to increase Chinese perceptions of Iran as a difficult place to do business, which in turn, will probably strengthen Chinese views of Saudi Arabia as a very reliable oil supplier and Iraq as a land of tremendous upstream opportunities. These sanctions, if successfully implemented, should raise the costs of making new energy investments in Iran and make it more difficult for Iran to maintain its oil production capacity over the longer term. In contrast, Saudi Arabia has the production capacity to make good on its promise to provide China with security of demand. Similarly, Iraq is already providing China's NOCs with opportunities to develop huge upstream projects at a faster pace than in Iran.

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