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Embracing Interdependence: The Dynamics of China and the Middle East

Chaoling Feng

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Embracing Interdependence: The Dynamics of China and the Middle East

Chaoling Feng[1]

China-Middle East Interdependence

By 2014, China had emerged as the Middle East's dominant trading partner. Many of the region's oil producers are highly dependent on oil export income from China. As interdependence in energy trade deepens over time, their corresponding importance to each other in business and strategic relations will also increase. Careful planning and adaptation is therefore essential for both sides. Depending on the adaptive strategies each party undertakes, their comparative positions and relationships could differ in important ways.

Since the 1960s, Organization of Petroleum Exporting Countries members, mostly located in the Middle East, have achieved rapid economic growth through global energy trade. More than 70 percent of OPEC members' export income derives from oil trade.[2] Prior to 2000, the economic well-being of Middle Eastern energy exporters depended on energy export revenues from Western Europe and North America. In the first decade of the new millennium, however, Middle East energy exports shifted rapidly toward Asia. In 2013, less than 20 percent of OPEC exports went to Western Europe and North America, whereas close to 70 percent of petroleum exports went to emerging Asian economies.

At the same time, China has become increasingly dependent on foreign oil, especially from the Middle East. In 2013, China imported 5.6 million barrels per day (b/d), second only to the 7.7 million b/d imported by the United States. China is on pace to overtake the United States as the world's largest oil importing country in 2016.[3] The Chinese government has estimated that its foreign oil dependence will increase to 61 percent for the five-year planning period ending December 2015.[4] Also, of China's total foreign oil imports, Middle Eastern countries account for a substantial 43 percent of supplies.[5] Saudi Arabia serves as China's single largest oil-trading partner, supplying 15 percent of the country's total annual imports. Five out of China's top ten oil suppliers are located in the Middle East: Saudi Arabia, the United Arab Emirates, Iran, Iraq, and Kuwait.

In addition, the Middle East-China energy trade nexus has expanded beyond oil. China's emerging interest in importing natural gas is one example. Until 2011, natural gas made up 4.6 percent of China's total energy consumption mix, far below the world average of 23.8 percent.[6] Since 2006, though, China's

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[2] OPEC, "OPEC Annual Statistical Bulletin—2014," June 2014, <http://www.opec.org/opec_web/static_files_project/media/downloads/publications/ASB2014.pdf>.

[3] Given the current trends of China's growth, China's oil imports are still growing at about five percent annually, whereas U.S. oil imports are decreasing by almost 10 percent per year. Calculations based on data from the Energy Information Agency database. See U.S. Energy Information Agency, "EIA database," accessed 15 October 2014, <http://www.eia.gov/countries/country-data.cfm?fips=ch>.

[4] State Congress of China, "The State Energy Development Planning: The 12th-five Plan: 2011-2015"[in Chinese], 1 January 2013, <http://www.gov.cn/zwgk/2013-01/23/content_2318554.htm>.

[5] Data derived from Massachusetts Institute of Technology, "Observatory of Economic Complexity," accessed 17 October 2014, <http://atlas.media.mit.edu/profile/hs/2709/>.

[6] Chinese State Energy Bureau, "Natural Gas Development: The 12th-Five Planning" [in Chinese], 22 October 2012, <http://zfxxgk.ndrc.gov.cn/Attachment/%E5%A4%A9%E7%84%B6%E6%B0%94%E5%8F%91%E5%B1%95%E2%80%9C%E5%8D%81%E4%BA%8C%E4%BA%94%E2%80%9D%E8%A7%84%E5%88%92.pdf>.

natural gas consumption increased steadily at an annual rate of 16 percent. In 2012, the Chinese National Development and Reform Committee (NDRC) further spurred demand growth by launching an implementation policy to promote the use of natural gas in a wide range of sectors, from central heating to electricity generation. To meet such fast-rising demand, China will have to rely increasingly on foreign imports. The NDRC report estimates that imports would provide 35 percent of these requirements by the end of 2015. While Central Asia provides the largest portion of China's natural gas imports, Qatar went from supplying no liquefied natural gas to China in 2009 to being its second largest supplier in 2013. China is now Qatar's fifth largest natural gas customer, accounting for 6.4 percent of its natural gas and LNG exports. From an energy trade perspective, the interdependent relationship between the Middle East and China is a symmetrical balance: the Middle East needs China as much as China needs the Middle East.

Another important trend concerns the expansion of Chinese energy investments and pertinent business development in the Middle East, especially after Iraq opened up to foreign direct investment in oil and gas extraction in 2007.[7] Direct investments, either in the form of whole ownership or equity investments, increased China's access to "equity oil"—i.e., guaranteed supplies at cheaper-than-market prices. In 2013, the biggest addition to China's Middle East imports oil was due to its direct investment in Iraqi oil wells. China surpassed the United States as the single largest foreign investor in the country, and in return, Iraq also became China's third largest oil supplier.[8] According to Platts-China senior editor Song Yanling, China's import of Iraqi crude oil jumped by almost 50 percent in 2013, reaching 165 million barrels, which was almost entirely attributable to the expanded investment in Iraq's oil wells.

Infrastructure construction to facilitate this energy trade has further increased interdependence between the two sides. In 2011, Qatar built its first terminal in China, in the eastern coastal province of Jiangsu, after the China National Petroleum Corporation (CNPC) signed the first long-term (25-year) LNG supply contract with Qatar for 3 million tons per year.[9] In the same year, Qatari's largest ship for LNG transport, with a load capacity of 266,000 cubic meters, began offloading exports at the Jiangsu CNPC Rudong Terminal. Meanwhile, China also expanded pipeline capacity, railroads, and other transportation infrastructure through inland routes to Central Asia and the Gulf states.

China has begun to implement its much-discussed "New Silk Road" strategy, a mid-to-long term plan to build transport infrastructure through Eurasia, Middle East, and Europe. China-Middle East interdependence will go beyond energy trade, extending to significant levels of commodity trade and business development.[10] Particularly, China has pledged to spend $40 billion to finance the construction of infrastructure at major checkpoints along old Silk Road trade routes, including those in the Arabian Peninsula.[11] As the New Silk Road economic beltway comes into formation, it is possible that the business

[7] In 2007, Iraq passed "Private Investment in Crude Oil Refining Law No. 64 of 2007," making it the first and only country in the Gulf region completely open to foreign investments in the energy extraction sector.
[8] After Saudi Arabia (15 percent) and Russia (14 percent).
[9] Daniel Canty, "PetroChina Takes First Gas Cargo from Qatargas," *Arabian Oil and Gas*, 29 May 2011, <http://www.arabianoilandgas.com/article-8938-petrochina-takes-first-gas-cargo-from-qatargas/>.
[10] The "New Silk Road" is the centerpiece (the "One Belt") of President Xi Jinping's "One Belt, One Road" strategy. The critical element of this strategy is to build infrastructure such as railways, ports, and roadways through Central Asia and Middle East to Europe.
[11] Based on the "One Belt, One Road" action plan approved in February 2015, major checkpoints in Iran and Turkey are included in the roadmap.

and service development ties could further extend to highly profitable sectors such as telecommunications, manufacturing, high-tech goods, logistics, and financial services. By the end of 2014, 77 out of 118 Chinese bilateral or trilateral free trade agreements were states lying on the "One Road, One Belt" Route.[12] In June 2014, Chinese President Xi Jinping launched the "1+2+3" China-Arab cooperation strategic plan, pushing deeper cooperation to include technological transfers and acquisitions in space, aviation, and nuclear energy.[13] Some investments are travelling the other way as well. The Qatar Investment Authority—one of the world's largest sovereign wealth funds—recently pledged to establish a significant $10 billion investment venture with China's CITIC Group.[14]

Sustaining Stability: Shifting Responsibilities

For a long time, China did not perceive conflicts in the Middle East and North Africa as having a direct impact on its interests, as China was not a major stakeholder in the region until very recently. China had no sophisticated strategies beyond its "non-intervention" principles to address foreign relations issues such as trade and other geopolitical interests in the region.[15] But as China rises to become a dominant economic partner for the region, however, continued non-intervention will put Chinese interests in jeopardy.

The possibility of energy supply disruptions creates an urgent need to establish an integrated energy trade and business development model among China and key Middle Eastern partners. However, China's position at the center of a "petroleum triangle" of Saudi Arabia, Russia, and Iran, complicates the picture—any broad, strategic actions might shift the balance of the triangle, challenging the interests of any one of the three.

In Syria, where China only had minor business interests of approximately $2 billion worth of investments, the CNPC had to terminate its joint venture with the Syrian national oil company in the aftermath of Arab Spring. In Libya, beyond losses in energy investments, the Chinese government had to evacuate more than 35,000 Chinese nationals as security conditions deteriorated, abandoning vast amounts of infrastructure and equipment.[16] In Iraq, China is the country's single largest foreign investor, and has encountered spiraling risks of disruptions to its assets, property, and flow of personnel as a result. China stands to lose billions in investments and risks the abrupt disruption of oil supplies if the Islamic State group takes over the country's oil fields. More importantly, China faces strong international pressure to contribute to the stability of the region. President Obama, during an interview with the New York Times, described China as a "free rider" to the U.S.-led NATO security sustainment operations in

[12] See the more detailed discussion of the FTAs in Chinese news coverage: "China Economic and Trade Cooperation Zones Overseas Have Reached 118 'Underway' in Addition to 77 Others" [in Chinese], *People*, 31 December 2014, <http://world.people.com.cn/n/2014/1231/c157278-26304390.html>.

[13] "Xijinping: Top-Level Planning, Establishing '1+2+3' China-Arab Cooperation Platform" [in Chinese], Xinhua, 5 June 2014, <http://news.xinhuanet.com/fortune/2014-06/05/c_1111000667.htm>.

[14] "Qatar, Citic Plan to Start $10 Billion Investment Fund," *Bloomberg News*, 4 November 2014, <http://www.bloomberg.com/news/2014-11-04/qatar-citic-group-to-put-5-billion-each-in-investment-platform.html>.

[15] China established the five principles of non-intervention in 1954 and since then has been using them as guidance for major foreign policy making. The five "non-intervention" principles include, mutual respect for each other's territorial integrity and sovereignty, mutual non-aggression, mutual non-interference in each other's internal affairs, equality and cooperation for mutual benefit, and peaceful co-existence. See Ankit Panda, "Reflecting on China's Five Principles, 60 Years Later," *The Diplomat*, 26 June 2014, <http://thediplomat.com/2014/06/reflecting-on-chinas-five-principles-60-years-later/>.

[16] "Adapting to Danger: Chinese Firms in the Middle East," *The Economist: Intelligence Unit*, 31 July 2014, <http://country.eiu.com/article.aspx? articleid=982112482&Country=China&topic=Economy&subtopic=Forecast>.

Iraq, channeling concerns that China benefits from U.S. provision of security in the region while investing little in its stability.[17]

Given the turmoil of the past few years, though, the relatively stable countries in the MENA region—mainly the members of the Gulf Cooperation Council—are likely attracted to the "stability-precedes-all" model embodied by China.[18] GCC members, particularly Saudi Arabia and Qatar, also have strained and sometimes troubled relations with their Western partners. Therefore, they also view China as a potential balance to their reliance on the West's provision of stability, especially now that China has become the single largest foreign business stakeholder in the region. However, as much as the Gulf states want to engage China in helping to stabilize the region, it is hard to tell to what extent China's strategic involvement would be welcome in the region at large. In Iraq, for instance, despite China's large investment stakes, Iraqi Foreign Minister Ibrahim Jafari was concerned that additional foreign presence would lead to increased anti-foreign sentiment among Iraqis.[19] Likewise, antipathy towards Chinese economic policies persists in Tehran.[20] The uncertainty about the need for a Middle East strategy has also become a concern among Chinese decision makers.

With increasing dependence on foreign energy, Chinese policymakers are deeply concerned about abrupt supply disruptions, whether caused by shifting production quotas, price wars, or violent conflict.[21] China has felt the urge to change its passive positions in global energy trade, as implied by the behavior of Chinese national oil companies. It has attempted to pursue mid- and long-term, government-to-government supply contracts with individual oil-exporting countries to replace current short-term supply deals.[22] China's most recent undertakings in Eurasia have demonstrated their ability to secure such long-term energy deals. For instance, during the 17th St. Petersburg Economic Forum, Russia agreed to sign a long-term crude oil supply plan for China—an equivalent of 46 million ton of crude oil for the next 25 years.[23] In the Middle East, China has been trying to negotiate similar long-term supply contracts with countries such as Saudi Arabia, but has largely failed thus far.

In addition to the supply contracts, the trade-in pricing rule is another component of the current trade model that China has a strong incentive to change.[24] For a long time, China was a price taker in global oil and natural gas markets. Historically, OPEC oil sale prices to Asian and OECD countries have relied on different benchmarks. Oil exported to Asia was priced against benchmark prices set in Abu Dhabi, whereas prices for the West were based on the West Texas Intermediate (WTI) or Brent

[17] B Xinhua, "Obama Labeling China as 'Free Rider' on Iraq Issue," *ChinaDaily*, 4 September 2014, <http://www.chinadaily.com.cn/world/2014-09/04/content_18543889.htm>.
[18] Jon Alterman, "China's Balancing Act in the Gulf," Center for Strategic and International Studies, August 2013, <https://csis.org/files/publication/130821_Alterman_ChinaGulf_Web.pdf>.
[19] Jeremy Bender, "China Signaled it May Join Operation against ISIS in Iraq," *Business Insider*, 15 December, 2014, <http://www.businessinsider.com/china-airstrikes-in-iraq-2014-12>.
[20] Erica Downs and Suzanne Maloney, "Getting China to Sanction Iran," *Foreign Affairs* 90, no. 2 (March/April 2011), <http://www.foreignaffairs.com/articles/67465/erica-downs-and-suzanne-maloney/getting-china-to-sanction-iran>.
[21] Jianhua Yu, "Thoughts on China-Arab Energy Cooperation" [in Chinese], *Arab World Studies* 6 (Nov 2011); CNPC, "Where Does the Confidence in Energy Security Come From?" [in Chinese], 8 August 2014, <http://wap.cnpc.com.cn/system/2014/08/08/001501572.shtml>.
[22] Liu Jiajun and Wang Chuan, "The Current Status, Barriers and Strategies Regarding China-Saudi Energy Cooperation" [in Chinese] *Globalization* 12 (2013), 57-66; W. Wang "Strategies for Expanding China-Saudi Arabia Oil Cooperation" [in Chinese] *China Energy News* 8 (2012), <http://paper.people.com.cn/zgnyb/html/2012-08/13/content_1097842.htm>.
[23] Sohu Finance, "China and Russia Signed Long-Term Oil Supply Contracts" [in Chinese], 24 June 2013, <http://business.sohu.com/20130624/n379627695.shtml>.
[24] Oil pricing rule: Trade-in price = Benchmark price + Differential value.

benchmark prices—usually at least 20 percent lower than the Arab benchmarks. For natural gas and LNG export, there is not a pricing rule that international traders widely agreed upon. However, historically speaking, LNG exports from the Gulf states to Asia have been at least 15 percent more expensive than those exported to European and North American destinations of similar transportation distance.[25]

As China becomes a dominant global buyer, this price differential will put it at a disadvantageous position. China will be increasingly driven to use its bargaining power to negotiate lower prices. Mr. Chen, the ex-CEO of CNPC, urged the Chinese government to establish an energy importing country alliance, a type of monopsony, to protect China's interest in oil pricing.[26] Mr. Yang, another expert in the field, commented on the People's Forum, a government mouthpiece, that the shifts in global energy supply-demand dynamics opened a window of opportunity for China to establish its own price benchmarking system comparable to WTI or Brent.[27] He warned that simply accepting the role of price-taker would affect China's long-term interests, undermining China's global image as a rising power.

The GCC nations have already lost some ground in energy exports to the West, as the North America energy revolution has rapidly advanced since 2009. The United States today is the least dependent it has been on foreign oil in decades. To win back the North American and European markets, GCC nations have waged a fierce price war since the summer of 2014, which has led to a precipitous 40 percent drop in crude oil prices. As of early 2015, this price war seemed likely to continue for the foreseeable future. Whether or not the Gulf states eventually regain dominance in North American market, the loss of profits represents unrecoverable sunk costs. By contrast, the comparatively high sale prices to Asia seem to serve as a safeguard for profit margins, even if the Gulf states fail to regain dominance in North America.[28] Therefore, from a business strategy point of view, the Gulf states would insist on maintaining energy trade mechanisms (including pricing and supply contracts) toward Asia. The reason is obvious: increasing demand from Asia, and especially China, is almost inelastic. This holds for almost all other major importers in Asia: Japan, South Korea, Singapore, and Taiwan. There is no scenario in which Asia, and particularly China, will be less dependent on the Middle East oil in the years ahead.

Furthermore, China has major energy and business stakes in all three "petroleum triangle" countries. Saudi Arabia is undoubtedly the largest supplier for Chinese energy needs, providing 14 percent of China's oil imports.[29] Not surprisingly, the second biggest source of Chinese oil imports is Russia (13 percent). Meanwhile, in Iran, even before Europe and the United States eased their sanctions and embargos, China already had major business stakes. As the sanctions were reduced in 2014, China further expanded its investments in the country. For 2015, China has doubled its quota on Iranian infrastructure from $25 billion to

[25] In terms of natural gas and LNG pricing, the distances from Qatar to Japan, the United Kingdom, and the United States are very similar: 10,560 km, 10,080 km, and 13,600 km respectively. But prices of LNG in Asian markets are much higher than those for OECD countries in Europe and North America. Between April and June 2012, despite LNG pricing hikes in Europe, prices there for Qatar's LNG never exceeded $10/million Btu, while Qatar LNG prices in Japan reached $11.5/million Btu, over 15 percent higher.

[26] Chen Bo, "China Crude Oil Import Status and Prospects" [in Chinese], Tsinghua University Center for China in the World Economy, 2009, <https://web.archive.org/web/20101011195207/http://www.ccwe.org.cn/journal/8/17.pdf>.

[27] Yang Zewei, "The Current Status of China's Energy Security and Strategy Options" [in Chinese], *People's Forum* 30 (2009).

[28] Whereas Brent prices dropped by more than 40 percent as of November 2014, Saudi's state oil firm Saudi Aramco actually raised its December price for its Arab light grade for Asian customers by $0.95 a barrel. See "Saudi Hikes Oil Prices to Asia, Europe, but U.S. Cuts Spook Market," Reuters, 3 November 2014, <http://www.reuters.com/article/2014/11/04/us-saudi-oil-price-idUSKBN0IO03320141104>.

[29] Alterman, "China's Balancing Act."

$52 billion, mainly to facilitate oil and gas extraction.[30]

Paradoxically, lying in the center of this entangled triangle, China, compared to other major foreign stakeholders in the region (such as the United States), could easily change the balance of the three with its economic leverage. Therefore, with China's investment and business expansion in perspective, this dynamic relational complex may serve as an important force to reshape their comparative positions.

Forking Paths

"Non-intervention" Versus Active Coordination

In the context of shifting responsibilities for regional stability, major Middle Eastern powers almost certainly expect China to provide support within certain boundaries. In fact, Saudi Arabia unilaterally included China as a "strategic partner" as early as 2006. But on the side of China, there is much support for simply adhering to non-intervention principles, with Chinese policymakers accepting a certain degree of risk as they pursue economic gains. However, the costs of inaction might ultimately prove too high.

First, although China's business interests in the Middle East are not on par with its interests elsewhere, disruptions could be disastrous. As discussed in previous sections, potential losses of billions of dollars in investments and the relocation of tens of thousands of Chinese nationals could incite serious controversy domestically about the government's inability to protect citizens and national assets. The political costs, in this sense, might far exceed the underlying economic losses and risks.

Second, an abrupt loss of the five percent of China's oil imports that comes from Iraq, whether due to actions of the Islamic State group or other security issues, could paralyze the Chinese economy.[31] This is because China does not have a sufficient emergency strategic petroleum reserve (SPR). As of December 2014, China only held a reserve equivalent to 16 days of foreign imports.[32] A five percent drop in supplies means that China's SPR would be depleted within nine months, before China could renew yearly contracts with other suppliers.

Third, inaction or non-intervention strategies give China no leverage in negotiating desirable energy deals, from pricing to supply contracts. As discussed in previous sections, China and the Middle East have irreconcilable conflicts of economic interest in energy pricing and trade mechanisms. Without other forms of leverage in play, such as support for stability, the dominant Middle East oil suppliers will not make concessions in these regards. As a result, the economic losses in trade due to inaction could exceed $40 billion per year, an equivalent of more than 20 percent of China's annual defense expenditure.[33]

Therefore, it is almost inevitable that China must forgo strict compliance with its non-intervention doctrine, and become proactively involved in the region. And it is in the best interest of both China and the Middle East to consider coordination and adaptation to replace the current non-intervention framework.

[30] "China to Double Iranian Investment," BBC, 16 November 2014, <http://www.bbc.com/news/business-30075807>.
[31] Iraq provides approximately five percent of China's foreign oil supplies.
[32] Sina Finance, "China Has a SPR of 12.43 Million Tons, Equivalent to Only 16 Days of its Crude Oil Import" [in Chinese], 24 November 2014, <http://finance.sina.com.cn/chanjing/cyxw/20141124/022520898068.shtml>.
[33] In 2013, the total value of China's imported crude petroleum products reached approximately $200 billion, and thus 20 percent higher-than-market-basket (compared to global market) prices are associated with approximately $40 billion of opportunity economic costs. China's recorded military expenditure in 2013 was approximately $188 billion.

Market-Based Platform versus Deal-By-Deal Negotiations

Another important choice facing China and the Middle East states is whether they should agree on an integrated market-based trade system or maintain the current practice of deal-by-deal negotiations.

The argument for an integrated market-based trade platform is intuitive—a free market serves as an "invisible hand" allocating profits among buyers and sellers efficiently, minimizing dead weight losses. Chinese experts predict that a market-based system would favor China, given its current disadvantageous position in import prices and supply reliability. On the Gulf side, an integrated market-based trade platform is not necessarily unprofitable, as long as it is established based on the demand and supply of Asian market, not markets elsewhere (such as North America). In fact, compared to deal-by-deal negotiations, an integrated market-based energy trade platform should bring at least the following advantages for both China and the Middle East.

For the Middle East, under a market-based trade mechanism, Chinese behavior would be more transparent. Even in the Asian market, China is quite different from other major importing countries such as Singapore, South Korea, and Japan. China is adjacent to Russia and Central Asia and has strong business ties with Iran, all of which are strong competitors in terms of energy exports. Opaque, collective actions between them will put pressure on Saudi Arabia and other major GCC countries when they negotiate individual deals, which in turn will put them in an unfavorable position. This will reduce the sustainable growth of the Middle East.

For China, a dynamic market-based trading system would be adaptable to both the ebbs and flows of energy demand due to changing economic situations, and also provide a buffer against abrupt disruptions in Iraq. Instead of depending on the negotiation of fixed supply contracts, China's energy supplies would be more secure, even without expanding the Strategic Petroleum Reserve.

Bilateral Diplomacy versus Regional Coordination

Compared to the intense, bittersweet, and sometimes-awkward relations with the West, Gulf nations' relations with China are too elusive to define. Currently, China's strategy towards Saudi Arabia, Russia and Iran is conducted on a case-by-case basis, with China trying to separate energy deals from geopolitics as much as possible. This individual relationship-building model between China and this triangle has functioned well insofar and could still hold for two reasons.

First, all the parties are aware of the fact that China is not as familiar with the Middle East affairs as other major foreign stakeholders, namely the United States and Europe. Historically, expectations about China's coordination have been set at a low point. Second, China is not confident that its economic potential (beyond energy) in the region is on a par with its opportunities elsewhere, especially in North American markets. High-level coordination without any reliable assessment of how the United States will respond might be simply risky, leading to bigger losses in North American markets. As the Chinese saying goes, they might "pick the sesame but lose the watermelon."

However, in the foreseeable future, the "petroleum triangle" should have higher expectations about China's role, as the public of the United States becomes fatigued with long-term Middle East engagements and is less dependent upon energy supplies from there. The ambiguity in regional coordination might create an atmosphere of distrust between the triangle and China. Under the existing noninterventionist strategic framework, China could easily put the three parties and itself under the typical "prisoner's dilemma," in which all the parties believe the others would defect and thus take actions resulting in the worst payoff for all. Or, in the worst-case scenario, this individual undertaking might backfire, with any of the three parties blaming China for being insincere in its cooperation.

At this stage, it is hard to tell whether close coordination or individual relationship building is in the best interest of any of the countries, even China. There are still information gaps that need to be filled.

Marching Onwards

Based on the analysis above, replacing the non-intervention principle with medium-to-long-term planning for modest engagements with the Middle East should be a high priority for China. An integrated, market-based energy trade system should be raised as a major agenda item of both China and the GCC nations. Before forming any strategic arrangements, all parties should further understand China's leverage in "petroleum triangle" relations. Particularly, there are some specific steps China and GCC nations could take despite the ambiguity of what increased intervention should look like.

China

First, to replace its current non-intervention strategy, China should establish more formative guidance for its political standing in the Middle East. As a first step, China could simply follow the blueprint it established in adjusting its non-intervention principles toward Africa (in 2006) and Latin America and the Caribbean (in 2008).[34] Particularly, China could apply several stability support positions to the Middle East as well:

- Military personnel training, high-level personnel exchange, and technological cooperation
- Peacekeeping and conflict resolution under the leadership of the United Nations Security Council
- Policing cooperation
- Information-sharing to build counterterrorism capability

Second, China should maintain an especially high level of transparency in any form of strategic engagement activities in the Middle East. This is in the best interest of China because it will assure the world that China's engagement (e.g. counterterrorism efforts) is genuinely intended to protect its assets and citizens in the region, not to pursue supremacy. Any skepticism of its motives stemming from opaque moves will cause China more trouble than benefits.

Third, China's initiatives should start small and increase gradually. China has already initiated bilateral dialogues with Middle East leaders. In 2004, the China-Arab State Cooperation Forum was established. This high-level strategic dialogue platform has already facilitated two rounds of Energy Cooperation Forums (in 2006 and 2010), engaging top government leaders including the Chinese Minister of Energy and his counterparts in Qatar and the UAE. China could continue to facilitate and participate in discussions and high-level dialogues and expert exchanges more frequently. This would help to build trust and identify priority areas where China could help the most in sustaining the region.

Fourth, as China continues trying to figure out its new stance toward the petroleum triangle, it should forgo its current strategy of

[34] Liu Zhongmin, "Transition in the Middle East and Several Diplomatic Issues Facing China" [in Chinese], International Review 1 (2012).

drawing a clear border between its own actions and those of the United States and Europe—long-term stakeholders in the region. For one thing, China could learn much from the two, as they have more knowledge about the region complex issues. Currently, China still has very limited independent knowledge or resources to understand Middle East affairs. Most understanding about the Middle East is still directly cited from foreign media or research reports. For another, it is not sensible to bypass the incumbent powers in the region. As Alterman writes, "it would be the end of the world if China had to choose between the U.S., Saudi Arabia, Russia and Iran."[35]

Lastly, but most importantly, as eager as China is to pursue a fair, market-based energy trade, it should deliberate on the all the options available, including:

- Sponsoring the inclusion of crude energy trade in more mature market-based platforms elsewhere in Asia, such as Singapore or Hong Kong, and equipping its national oil companies with capabilities to trade in dynamic markets.
- Establishing an independent and transparent crude energy trade platform within China's territory, preferably in Shanghai.
- Incorporating crude energy trade into the catalogue of existing commodity exchanges, such as the Beijing Commodity Exchanges.

In addition to those options, policymakers can also construct combinations of them. Whatever options are adopted, China's energy economy could benefit extensively from fair market trading, but China should also expect higher transparency requirements for its national oil companies in the process of trading.

GCC Countries

As energy trade shifts toward the East, the continued prosperity of the GCC countries will be largely determined by their trade and business activities with Asia, especially energy-hungry economies like China's. Waging price wars to win back the North America market, as effective as it appears, does not create sustainable advantages in the market. The temporary success, at its best, is the equivalent of cashing out pension funds early at extraordinarily high discount rates. Therefore, it is urgent that GCC countries readjust their business and strategic relations, prioritizing strategies and adaptations to China and the Asian market at large. Specifically, several major moves can help strategic prioritization.

First, GCC countries could identify opportunities to transform their crude energy export based economic structure. For almost four decades of export to the West, GCC revenues have mostly come from crude energy. However, increasing the sales of crude oil and natural gas products does not bring especially high economic gains. In contrast, investments in downstream refineries bring more value-added returns. Whereas the GCC countries don not necessarily have technological advantages over operators in refineries from North America and Europe, they do when compared to Chinese national oil companies (NOCs). Particularly, given their advantages as crude oil suppliers, GCC countries can adopt the vertical integra-

[35] Jon Alterman, "Statement Before the U.S.-China Economic and Security Review Commission: China in the Middle East," 6 June 2013, <http://csis.org/files/attachments/ts130606_alterman.pdf>.

[36] China's refinery industry is open to foreign investment, with competition intended to upgrade its refining technologies and increase its refining capacity. Sinopec, Saudi's Aramco Overseas Company, and Exxon Mobil already established a joint venture refinery in Fujian, China. The equity breakdown among the three is: 50 percent, 25 percent, 25 percent. See data at Sinopec, "Fujian Petrochemical Co., Ltd." [in Chinese], <http://www.sinopecgroup.com/group/gsjs/shwq/fjlhgs.shtml>.

tion strategy. For instance, this could mean investing in China's downstream refineries that promise high profit margins.[36]

Second, in addition to investing in China and elsewhere, GCC countries should also consider welcoming foreign investment to promote innovation and increase competitiveness. In particular, GCC countries might consider opening up the energy sector, which has traditionally been closed to foreign stakeholders. This might affect the region in certain ways:

- Replacing strict buy-out contracts with profit-sharing contracts may attract foreign investors, including major international oil companies as well as major NOCs such as CNPC, which are crucial to promote technological innovations, particularly for extraction.

- Introducing foreign investment is a deeper level of engagement compared to buy-back or other operational contractors. This would thus increase interdependence, with the GCC countries and investors sharing vulnerabilities and uncertainties in the global energy markets.

In the non-energy sectors, Arab countries should seriously consider the economic and trade potential brought about by China's recently ratified "One Belt, One Road" action plan. It is sensible to consider signing bilateral or multilateral FTAs with China and other countries along the route. In addition, trade with and investments in China in the peripheral sectors such as shipping, infrastructure, and high-tech goods can play an important role in creating new incentives for economic growth in the region. More importantly, these sectors have the largest potential to create a great amount of jobs for low-skilled youths, which will help reduce high youth unemployment rates, a fundamental source of instability in the GCC and neighboring Middle East countries. Last but not least, China and other Asian countries might negotiate for mid- and long-term energy supply deals. It is necessary that they deliberate on the economic and strategic tradeoffs between short-, mid-, and long-term contracts, as well as bilateral agreements. Continuing market-based short-term supply contracts will increase responsiveness to energy trade dynamics by closely engaging in international operations, which is a comparative advantage to maintain competitiveness in the global market. On the other hand, given the instability in global energy market transition, closed long-term contracts might actually benefit the oil exporting countries in the face of strong competitors and unpredicted price drops.

Conclusion

As the Middle East's predominant trade partner, China has an inherent interest in bargaining for more favorable import prices under new pricing benchmarks and devoting more direct investment to energy and peripheral sectors. As the Middle East carries more significance for its energy supply security, China may revise its "non-intervention" principle to smooth trade relations and geopolitical relations at large.

For GCC countries, China's steadily increasing energy imports from the region will safeguard its exports for the foreseeable future. On the other hand, as China and Asia at large are becoming predominant trade partners, GCC countries should be aware of their increasing negotiating power. Meanwhile, GCC countries should also note potential opportunities to pursue higher profit margins at the downstream refinery chains and attract job-creating investments within its territory, both in energy and non-energy sectors.

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