

Embassies Dialogue on Asia

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Summary: China's response to the U.S. sanctions against the Central Bank of Iran is likely to be an important determinant of the extent to which the United States is successful in weakening the Iranian economy by reducing Iran's income, especially if other major buyers of Iranian oil curtail their purchases. Eliciting cooperation from Beijing on Iran is challenging for Washington because China's equities in Iran, views of the efficacy of sanctions, and prioritization of the Iranian nuclear issue on its foreign policy agenda are different from those of Washington. As Washington once again seeks support from Beijing for its efforts to pressure Iran, it is worthwhile to examine recent U.S.-China cooperation on the Iranian nuclear issue and why that cooperation occurred. This essay will detail China's contributions to the U.S.-led efforts to pressure on Iran in 2010 and explain why the Chinese provided them. It will then highlight some factors that might elicit more cooperation from China on constraining Iran's nuclear program.

Cooperating with China on Iran

by Erica Downs

China's response to the U.S. sanctions against the Central Bank of Iran (CBI) is likely to be an important determinant of the extent to which the United States is successful in weakening the Iranian economy by reducing Iran's income stream, especially if other major buyers of Iranian oil curtail their purchases. The new law, signed by President Barack Obama on December 31, 2011, prohibits financial institutions that do business with the CBI from also doing business in the United States. It affects China because Chinese oil traders imported more than 500,000 barrels per day of oil from Iran last year and made payments for some of these supplies into an account that the CBI holds with a Chinese state bank.

Beijing's initial reaction to the U.S. restrictions on the CBI indicates that Chinese compliance may be difficult to obtain. China's Ministry of Foreign Affairs has publicly declared its opposition to the new U.S. sanctions. A foreign ministry spokesman has stated that the sanctions will not influence China's energy cooperation with Iran because "these interactions do not violate U.N. Security Council resolutions and will not impair third party interests. Therefore, these

interactions should not be affected."¹ Moreover, Vice Minister of Foreign Affairs Cui Tiankai has further indicated that the Chinese government is unlikely to order Chinese oil traders to stop buying oil from Iran to pressure Tehran, noting that: "The normal trade relations and energy cooperation between China and Iran have nothing to do with the nuclear issue. We should not mix issues with different natures, and China's legitimate concerns and demands should be respected."²

Eliciting cooperation from Beijing on Iran is challenging for Washington because China's equities in Iran, views of the efficacy of sanctions, and prioritization of the Iranian nuclear issue on its foreign policy agenda are different from those of Washington. First, China has substantial economic interests in Iran. Iran is China's third largest supplier of crude oil, and China's national oil companies (NOCs) have contracts to develop several large oil and natural gas fields in Iran. Second, Beijing does not regard robust sanctions as an effective tool of statecraft. Chinese officials hold that limited sanctions can be useful in signaling to

¹ "China opposes 'unilateral' U.S. sanctions on Iran," *AFP*, January 4, 2012.

² Joe McDonald, "China rejects linking trade and Iranian nukes," *Associated Press Financial Wire*, January 9, 2012.

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the targeted state that it is time to return to the negotiating table but also believe that comprehensive sanctions are counterproductive. These views are shaped by China's first-hand experience as the subject of Western sanctions, some of which are still in place. Third, although Beijing does not want Iran to acquire a nuclear weapons capability, it probably does not consider constraining Iran's nuclear ambitions to be as vital a national security interest as Washington does.

Despite these factors, China has contributed to the attempts of the international community, spearheaded by the United States, to constrain the development of Iran's nuclear program. In 2010, China supported United Nations Security Council Resolution (UNSCR) 1929, which contains the most meaningful multilateral sanctions on Iran to date. China apparently is also partially complying with the Comprehensive Iran Sanctions, Accountability, and Divestment Act (CISADA), enacted by the United States in 2010. Beijing's cooperation is partly due to U.S. diplomacy and pressure from other countries. Moreover, Chinese firms, in response to both instructions from the Chinese leadership and their own business calculations, have scaled back their activities in Iran.

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China and Iran Sanctions: State of Play

U.S.-China cooperation on Iran in 2010 was the high point of an otherwise very rocky year in the bilateral relationship. Washington and Beijing made little progress in working together to curb North Korea's uranium enrichment program and restrain its destabilizing behavior, combat climate change, and reform the global economic order. Moreover, tensions flared between the countries over a variety of issues, including the South China Sea, U.S. arms sales to Taiwan and President Obama's meeting with the Dalai Lama. However, China did participate in the U.S.-led

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effort to prevent Iran from acquiring a nuclear weapons capability.

First, Beijing endorsed UNSCR 1929, which contains more muscular sanctions than any other previous resolutions on Iran, all of which China supported. UNSCR 1929 contains a fairly comprehensive arms embargo. Perhaps more importantly, the resolution, which was unanimously approved by the five permanent members, provided a justification for countries to implement even stricter unilateral sanctions against Iran.

Second, China appears to be partially complying (in spirit if not in letter) with CISADA, which not only mandates penalties against foreign companies that invest in Iran's energy sector but also against firms that sell gasoline to Iran. After the United States enacted CISADA, the Chinese government instructed China's NOCs to slow down their work on projects in Iran. The NOCs responded accordingly. China National Petroleum Corporation (CNPC), for example, is developing Phase 11 of the South Pars natural gas field at a much slower pace than stipulated by its contract. CNPC's cumulative investment in South Pars as of August 2011 was only \$18 million, under the CISADA threshold of \$20 million per year and the \$400 million that Iranians claim CNPC promised to spend annually.³ The company's inactivity prompted the Iranians to threaten to void CNPC's contract unless it makes more rapid progress, a fate that recently befell the Russian firm Gazprom Neft. Moreover, Iran has also temporarily suspended the contract held by China National Offshore Oil Corporation (CNOOC) for the development of the North Pars natural gas field due to the firm's lack of progress. In addition, China's NOCs have heeded Washington's warning not to

³ Samuel Ciszuk, "President Calls for Complete Energy Nationalization, Putting Brave Face on Iran's Investor Exodus," *IHS Global Insight*, August 10, 2011.

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“backfill” projects abandoned by European and Japanese firms.

Chinese firms, however, reportedly continued to provide Iran with gasoline, including by bartering it for crude oil. These transactions were probably motivated by both U.S. and UN sanctions, which have made it difficult for China to pay for its crude imports from Iran (556,000 barrels per day in January-November 2011) and by the higher prices the Iranians may be offering for gasoline. Such barter arrangements may not comply with CISADA, which authorizes penalties against firms that provide Iran with gasoline with a fair market value exceeding \$1 million. In January 2012, the U.S. Department of State imposed sanctions on the Chinese firm Zhuhai Zhenrong for gasoline deliveries to Iran.

Explaining China's Cooperation

China's support for UNSCR 1929 and apparent partial compliance with CISADA are probably due to several factors. Pressure from the United States and other countries undoubtedly played a role because China does not want to be isolated on major global issues. However, the commercial calculations of Chinese companies, which were shaped by the allure of the U.S. and European markets and the difficulties of doing business in Iran, have also contributed to U.S.-led effort to isolate Iran.

American Diplomacy

The United States-China relationship is China's most important bilateral relationship, and pressure from the Obama administration almost certainly influenced Beijing's calculus. When he assumed the presidency, Obama elevated the importance of Iran in the bilateral relationship. Not only is nonproliferation a key pillar of Obama's foreign policy, but he also identified nonproliferation as one of several

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global challenges on which he wanted Washington to work with Beijing to address. The Iranian nuclear issue was a high priority for Obama when he visited Beijing in November 2009. Two weeks before his visit, two senior White House officials traveled to Beijing to persuade the Chinese to press Iran. They argued that failure to constrain Iran's nuclear program might result in two developments inimical to Chinese interests: Israel bombing Iran or Saudi Arabia and other states in the region going nuclear. Iran also dominated Obama's meeting with Chinese President Hu Jintao before the Nuclear Security Summit in Washington, DC, in April 2010. After the meeting, the White House announced that China was prepared to work with the United States on a sanctions resolution.

Pressure from Saudi Arabia

Arguments from Saudi Arabia probably reinforced U.S. pressure on China to support new multilateral sanctions on Iran. When considering sanctions, the Chinese take into consideration the views of regional stakeholders. Riyadh's views are important because Saudi Arabia is China's largest supplier of crude oil, providing 20 percent of China's imported crude (999,000 barrels per day in January-November 2011). Saudi Arabia regards Iran's nuclear program as a threat to its national security. Prince Turki al-Faisal, who previously served as Saudi Arabia's intelligence chief and ambassador to the United States, recently stated that Iran's quest for — and Israel's presumed possession of — nuclear weapons might prompt Saudi Arabia to follow suit.

In 2009 and 2010, the Obama administration pressured Saudi Arabia to use its economic leverage with China to persuade Beijing to vote in support of new sanctions on Iran in the UNSC, reportedly including offering to make up any disruptions in China's oil supply resulting from new UN sanctions. The Saudis did tell the Chinese they were willing to address China's oil supply concerns if Beijing played a more proactive role in curbing Iran's nuclear program. However, the extent to which the Saudis' decision to pressure the Chinese stemmed from their own national security concerns versus exhortations from the Americans is unclear. It is also unclear what, if anything, the Saudis offered the Chinese to vote in support of UNSCR 1929 other than general reassurances about oil supplies.

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Russian Facilitation

Russian support for UNSCR 1929 likely contributed to Chinese support for the resolution. Although Russia and China often vote together in the UN, they have different interests with respect to Iran. Russia considers the prospect of a nuclear-armed Iran more threatening than China does. Moreover, constraining the development of Iran's energy sector also benefits Russia, a major energy producer and exporter. In addition, Moscow's frustration with Tehran over its walk away from a nuclear fuel swap deal involving Russia, and the revelation of the previously secret nuclear facility in Qom also deprived China of a partner with whom to oppose new multilateral sanctions and avoid international isolation. Perhaps most importantly, the re-set in U.S.-Russia relations — and specifically the new START treaty signed by Washington and Moscow in April 2010 — undoubtedly inclined Moscow to support new multilateral sanctions. Faced with standing alone or supporting the new resolution, Beijing chose the latter.

The Allure of U.S. and European Markets

Chinese companies have pulled back from Iran to avoid jeopardizing opportunities to expand in the United States and Europe. Two of China's NOCs, CNOOC Ltd. and PetroChina, have assets in the United States and would like to make more investments. In addition, in early January 2012, Devon Energy announced that Sinopec had agreed to invest \$2.2 billion in five of Devon's shale projects in the United States. Similarly, the recent announcement by Chinese telecommunications equipment manufacturer Huawei Technologies that it will scale back its operations in Iran, despite being in compliance with U.S. and EU laws, is at least partially motivated by its ambitions to do business in the United States and Europe. In short, some Chinese firms are prioritizing the United States and Europe over Iran in response to sanctions.

The Difficulties of Doing Business in Iran

Iran has also made it easier for Chinese firms to curb their activities there by being a tough place to do business. China's NOCs will likely have difficulty turning a profit because of the tight fiscal terms offered by the Iranians. The NOCs are also reluctant to invest large sums of money in Iran because of uncertainty over how the international community will respond if Iran does not curtail its nuclear program. Moreover, one of the main motivations behind

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CNPC's investment in South Pars — the export of liquefied natural gas (LNG) to China — has largely disappeared. Iran is unlikely to export LNG anytime soon because of burgeoning domestic demand for natural gas and the fact that Iran does not have access to liquefaction technology due to sanctions.

Lessons Learned

Gaining Chinese support for the U.S. restrictions on the CBI is likely to be a difficult and protracted process. Not only is China opposed to the new unilateral sanctions, but Chinese economic ties to Iran, and the likelihood that Beijing does not regard constraining Iran's nuclear program as vital a national security interest as Washington and some other capitals do, will undoubtedly continue to pose a challenge to the attempts of the United States and other countries to pressure Iran. However, China's recent contributions to the U.S.-led efforts to pressure Iran indicate that several factors might yield some additional cooperation:

- *International Pressure:* Sustained pressure from multiple sources can help persuade Beijing to support multilateral sanctions because China does not want to be isolated on major international issues. Key sources of pressure include the United States (because the U.S.-China relationship is China's most important bilateral relationship) and states in the Middle East (because Beijing takes into consideration the views of regional stakeholders when deciding whether to support sanctions).
- *Investment Opportunities in the United States:* The more that Chinese companies, especially China's NOCs, are invested in the United States, the more likely they are to think twice about doing business in Iran. However, increasing Chinese investment in the United States will

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require creating a more predictable and welcoming environment for Chinese firms. The controversy generated by CNOOC Ltd.'s attempt to purchase the U.S. oil company Unocal in 2005 and Huawei's unsuccessful bids to expand in the United States have convinced many Chinese executives that the United States is a politically challenging place to invest.

- *The Prospect of War in the Persian Gulf:* While Beijing is no fan of sanctions, it probably likes a military conflict over Iran even less. China regards instability in the Persian Gulf as a threat to its oil security. The prospect of supply disruptions and higher prices resulting from an attack on Iran might prompt Beijing to step up its efforts to pressure Iran.
- *Protection of (some of) China's Economic Interests:* China is more likely to support and comply with sanctions that protect some of China's economic interests. One of the reasons China supported UNSCR 1929 is because it did not contain any penalties for investment in Iran's energy sector. Similarly, the Obama administration's focus on persuading China's NOCs not to "backfill" projects abandoned by European and Japanese companies instead of giving up their existing projects has probably been effective because it is consistent with the Chinese NOCs' Iran strategy — to hold onto the projects for which they have signed binding agreements but to delay making any substantial investments in these projects until it is safe to do so.

About the Author

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About the Embassies Dialogue on Asia

The Embassies Dialogue on Asia was launched by the German Marshall Fund in the fall of 2011. Organized by GMF Transatlantic Fellow Dr. Daniel M. Kliman and sponsored by the South Korean Embassy to the United States, it brings together young American experts on Asia, diplomats from Asia-Pacific embassies, and European diplomats in Washington with portfolios encompassing Asia to create a unique venue for informal discussion. The Embassies Dialogue on Asia is part of GMF's Asia Program, which addresses the implications of Asia's rise for the West through a combination of convening, writing, strategic grants, study tours, fellowships, and partnerships with other institutions. For more information, see <http://www.gmfus.org/asia>.

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