BELT AND ROAD INITIATIVE: Toward Greater Cooperation Between China and the Middle East

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# Table of Contents

1. Introduction 1

2. Key Takeaways 2

3. Session One: The BRI and MENA in a Changing Global Landscape 4
   • Context
   • MENA contribution (Yahia Zoubir)
   • China contribution (Yang Fuchang)
   • Discussion

4. Session Two: The BRI and Infrastructure Development in MENA 7
   • Context
   • MENA contribution (Nader Kabbani)
   • China contribution (Wang Zhen)
   • Discussion

5. Session Three: Economic and Trade Cooperation Between China and MENA 10
   • Context
   • MENA contribution (Raed Safadi)
   • China contribution (Yuan Bo)
   • Discussion

6. Session Four: Production Capacity Cooperation and Industrialization in MENA 13
   • Context
   • MENA contribution (Mustapha Nahlili)
   • China contribution (Zhang Youwen)
   • Discussion

7. Session Five: Banking and Financial Cooperation Between China and MENA 16
   • Context
   • MENA contribution (Nasser Saidi)
   • China contribution (Ding Yifan)
   • Discussion

8. Session Six: Energy and Resource Cooperation Between China and MENA 19
   • Context
   • MENA contribution (Ibrahim Saif)
   • China contribution (Pan Guang)
   • Discussion
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On January 13–14, 2018, the Brookings Doha Center (BDC) and the Shanghai Academy of Social Sciences (SASS) convened prominent experts from the Middle East and North Africa (MENA) and China for an in-depth discussion of the Belt and Road Initiative (BRI). Initiated by President Xi Jinping in October 2013, the BRI aims to direct considerable resources toward infrastructure projects, including railways, ports, pipelines, and utility and telecommunication networks across more than 60 countries. It also aims to establish the world’s largest platform for economic cooperation, including policy coordination and trade and financial partnerships running through Central Asia, MENA, all the way to Europe.

The MENA region, in particular, is a major constituent in the development and realization of BRI. In addition to its geographic significance as a link between Asia, Africa, and Europe, MENA is China’s biggest supplier of energy resources and one of its biggest trading partners. Economic growth and various development prospects associated with BRI promise to feed into ongoing structural transformations and to address financing needs in the region. Additionally, mega infrastructure projects and financial investments abroad offer credible pathways for China’s proposed socioeconomic and political strategy toward MENA, while simultaneously addressing its domestic overcapacity issues at home.

The BRI’s plans in MENA have been elaborated in China’s 2016 Arab Policy Paper, which highlights the Chinese government’s vision for enhanced relations with countries in the region. More specifically, the paper puts forward a three-layered strategy for greater BRI collaborations; the first is energy cooperation, second is infrastructure construction and trade and investment facilitation, and the third is innovative technologies in nuclear energy, space satellite, and renewable energy. These plans have guided ongoing bilateral dialogue between China and MENA governments and have shaped the agenda of ministerial meetings under the China-Arab States Cooperation Forum.

The discussions at the Shanghai workshop examined the principal areas outlined in the 2015 BRI action plan, as well as key articulated policies on China-MENA BRI engagement. Topics ranged from the global context for China-MENA economic and political relations to more specific BRI-focused areas including infrastructure development, economic and trade cooperation, production capacity and industrialization, banking and financial markets integration, and energy and resources. Participants addressed policy questions around BRI’s plans, and they dealt with technical aspects of their implementation through a series of structured panels and open debates.

The workshop took place against a background of growing geopolitical tensions between China and the United States, diminished faith in the forces of globalization and emerging trade wars, important structural changes underway in international energy markets, and growing regional instability and conflict in MENA. The BRI itself has come under increasing scrutiny by international observers and the media. While acknowledging the potential negative impact of these dynamics on the BRI and China-MENA relations, by and large participants emphasized the mutual benefits that could be achieved with the careful design and implementation of BRI and, more generally, deeper cooperation between China and MENA.

In the interest of broadening the dialogue and disseminating the findings, we present below a summary of the proceedings from the Shanghai workshop.
Changing Geopolitics

China has set out to pursue the BRI at a time when the international system is under stress. Protectionism is on the rise as trade wars intensify. Multilateralism is giving way to geopolitical confrontation. Faith in the liberal economic order by growing segments of publics around the world is losing out to nationalist priorities. The BRI challenges those trends, emphasizing international cooperation, mutual development, and stability.

The BRI has largely been welcomed in the MENA region: first because it emphasizes economic development, and second because it adopts a policy of non-interference in regional and domestic affairs at a time of economic dislocation, geopolitical uncertainty, and domestic turmoil across the region. It remains unclear whether the BRI model will prove capable of responding to MENA’s increasingly complex economic and political challenges.

Infrastructure Development

China’s development model has relied on massive investments in infrastructure to generate rapid economic growth. Through expanding railways, pipelines, and ports along the BRI, China aspires to roll out its domestic development model along Eurasia and Africa to boost global economic growth and deepen access to international markets.

While China is investing in a growing number of projects in MENA, it has avoided making the Arab region a linchpin of its BRI strategy, despite the fact that the region sits at the crossroads of Europe, Africa, and Asia and can serve as a hub for global connectivity. Serving as a hub for such an ambitious network requires a level of stability and cooperation that is lacking at present. This is an enormous missed opportunity for Arab countries. The development of infrastructure can not only help expand growth and diversification, but also much needed job creation. Further, while an infrastructure-driven development model is by no means the only answer for political instability, it can improve future outlook and socioeconomic outcomes in MENA.

Economic and Trade Cooperation

China’s trade with MENA continues to be heavily skewed toward energy, with oil and gas going one way and manufactured goods going the other. The BRI presents an opportunity for cooperation beyond energy, particularly with the Gulf Cooperation Council (GCC) given its location and infrastructure, and with negotiations for a free trade agreement (FTA) with China advancing.

Deeper MENA-Sino cooperation in trade and investment has the potential to boost economic development and diversification plans for all concerned parties. However, the potential benefits are not automatic and require not just infrastructure investments but, most importantly, broader institutional arrangements and policy changes.

Enhancing MENA’s competitiveness requires deepening regional cooperation, including in such areas as competition, investment laws, and incentives granted to foreign investors; commercial laws governing ownership of companies and properties; shipping and movement of cargo; aviation and air transport; and banking and finance.

Production Capacity Cooperation and Industrialization

Decades of investment-led growth have left China with a production capacity that is unprecedented in its sheer scale. This has structurally transformed China’s economy, while creating a situation where demand for the nation’s products is less than potential supply. If leveraged properly, the export of excess capacity could be beneficial for China and developing BRI countries.

China’s excess capacity is made-up of three components: the capacity to produce material inputs, to produce standardized machinery and equipment, and to implement large-scale projects. There are three channels this production capacity may be used for to improve development/industrialization in places like MENA: open trade, public project contracting, and foreign direct investment (FDI).

Excess capacity cooperation between China and MENA has significant potential, although it would not translate to fundamental changes in the growth trajectories of MENA countries unless they embrace new strategies for integration and industrialization. This will also require China to adopt a partnership-based model in working with governments and firms in MENA.

Banking and Financial Cooperation

Multilayered funding sources and modalities could pave the way for broader banking and financial cooperation between China and MENA in support of trade facilitation, sovereign lending, digital banking, and the internationalization of the RMB. Yet, the two parties continue to rely heavily on the dollar and euro in their financial transactions despite the risks and costs.

The growing presence of Chinese banks in the GCC provides the financial underpinning for deeper and wider linkages. Banks and sovereigns in MENA should make use of this opportunity to provide co-financing for BRI countries, as well as to push for public & private co-financing of BRI projects, thereby bringing MENA closer to China.

The GCC banking sector is slowly pivoting East in tandem with the shift of economic geography, and in the process, it is pushing the region to be a part of the growing Yuan zone. The BRI could boost the internationalization of the RMB by encouraging its use in both trade and financial transactions as the petroyuan gains market share from the dollar and euro.

Energy and Resource Cooperation

MENA will remain essential to China’s energy security. The geopolitical upheaval in MENA in recent years has not significantly changed energy cooperation between China and MENA’s hydrocarbon-exporting nations, although it has affected some key trade routes and opened the door to competition from third parties.

China’s thriving economy has propelled it past the United States as the world’s largest net oil importer. At a time when the United States continues to demonstrate a preference for non-MENA sources of oil, the bond between MENA oil-producing nations and Chinese companies raises questions about China’s willingness to contribute to security and stability in the region.

The BRI identifies the energy sector as a key area that could lead cooperation between MENA and China in the future. Yet, this underplays the fact that the energy relationship between the two can be extended beyond this traditional framework. Recent developments in technology, especially relating to clean and renewable energy, are going to alter the structure of supply and demand globally over the next decade or so, presenting a new avenue for deeper partnership. This will require agility on both the demand and supply side in order to be able to adopt and adopt emerging technologies.
Session One

The BRI and MENA in a Changing Global Landscape

The world suffers from geopolitical dislocation. The international system is under stress. Protectionism is on the rise. Regional organizations aimed at cooperation and economic integration, even in Europe, are under stress. MENA, which was home to numerous efforts at regional cooperation in the previous century under bodies such as the Arab League, the Organization of the Petroleum Exporting Countries, and the GCC, witnessed the successive failure of those bodies as the region slowly descended into conflict. It is within this context that China hopes to put forward the BRI, going as far as to enshrine it within its constitution, emphasizing international cooperation, peace, and stability at a time when those ideals have been clouded with doubt.

Speakers: Yahia Zoubir, Professor of International Relations and International Management and Director of Research in Geopolitics at the KEDGE Business School; and Yang Fuchang, Former Vice Minister of the Ministry of Foreign Affairs and former President of the Chinese Association of Middle East Studies.

The welcome multilateralization of global power

Yahia Zoubir

Both China and MENA are changing, and so are the dynamics of their relationship with each other. Despite lower GDP growth in recent years, China has been growing at remarkable levels and has become home to a middle class of around 400 million people. Such growth has translated to a continuous thirst for energy and resources, which have been key in China’s ties to MENA.

Yahia Zoubir

Yet, China’s Arab Policy Paper suggests that it will move beyond energy in MENA, focusing on construction, trade, and investments. This coincides with some dramatic changes in MENA. The region has been transforming its relationship with the outside world, as can be seen in the rapprochement between some Gulf Arab states and Israel, but also in MENA’s changing relationship with China. Those new relations are a response not only to the changing socioeconomic makeup of MENA countries but also to the conflicts that are reconfiguring the regional map.

It is in the midst of these changes that President Xi launched the BRI, which aims at meeting China’s demands for energy and opening up markets for its surplus products. Should the BRI proceed without hindrance, China would gain both economically and politically and increase its influence globally. Such multilateralization of global power could potentially bring about a more stable, peaceful world order.

Many MENA countries have observed that they have been the losers under the West’s hegemonic order, regardless of their respective alignments with Western powers. They have been subject to outside interference with little benefits. China never colonized MENA countries or interfered in their domestic affairs. The country’s regional and international expansion is natural and inevitable due to its economic weight. Its policy of noninterference certainly appeals to MENA states. Those factors partly explain the region’s acceptance of the BRI and China’s larger role in the global arena.

Such an expanded role would increase pressure on China to manage the numerous conflicts that plague MENA. China has the potential to be a neutral mediator in a variety of MENA conflicts, but it has yet to show a willingness to step in to bring peace. For instance, China’s current attempt to balance its relationship between Iran and Saudi Arabia, two of its major energy suppliers, may not be sustainable. It is unlikely that the two rivals would put their differences aside in an attempt to benefit from the BRI and other economic projects, and China may eventually be forced to take sides. Relatedly, Iran and Saudi Arabia play a significant role in the proxy war in Syria, where China may also need to step-up its role. To effectively achieve its geopolitical ambitions, China would have to learn how to be a heavyweight mediator in a complicated region like MENA, where it lacks experience.

In fact, China has not yet shown any strategic designs in MENA. It has yet to offer a clear model of development capable of succeeding the dominant economic liberal model that has dominated the global order. Moreover, it is unclear how China will transform its economic relations into close political and cultural ties. While China has established strategic partnerships with countries such as Algeria, Egypt, Iran, and Saudi Arabia, those ties rest mostly on trade. China still lacks soft power influence in MENA. It needs to develop cultural exchanges with the region, including through expanding Middle East studies in its universities and creating a mass of MENA experts.

In sum, the BRI is an ambitious project that can differentiate China from Western powers in MENA. However, China has a long way to go in supplanting Western influence in the region.

China’s appeal in a changing geopolitical landscape

Yang Fuchang

China has enjoyed strong diplomatic ties with all countries of the Arab League, beginning with Egypt in 1956. Over more than 60 years, friendly Sino-Arab relations have smoothly shaped-up without any conflict or confrontation. Those relations have been characterized with mutual respect, where both parties acknowledge the differences in their social systems and respect each other’s choices. This is fortified by mutual support, particularly on core issues that affect both sides. For instance, the Arab side has advocated a one-China policy, while China has stood by the Palestinian plight to establish an independent sovereign state with East Jerusalem as its capital.

In addition, the two sides have engaged in a long history of mutually beneficial economic cooperation. The two sides are highly complementary economically and have great potential for growth. In fact, even during the current period of turmoil in MENA, bilateral trade with China has continued to rise. Sino-Arab trade rose from $145.4 billion in 2010 to $195.9 billion in turbulent 2011. By 2014, it reached $251 billion, up from $36.7 billion when the two sides launched the Sino-Arab Cooperation Forum 10 years before in 2004. In 2016, China imported 154 million tons of oil from Arab countries, accounting for 40.52 percent of its total oil imports that year. When we include oil imports from other non-Arab MENA countries, the amount reaches 191 million tons of oil, taking up 51.15 percent of that year’s total.

When we put these realities in mind, MENA’s quick and positive reaction to China’s BRI proposal in 2013 comes as no surprise. But there is more to China’s appeal within this changing geopolitical landscape. First, China’s initiative promotes development as a fundamental lever for addressing local and global problems. It proposes to link-up the development plans of all countries and regions with the hope of jointly building a global community through consultation and consideration for collective interests. This vision is espoused at a time when the Arab region is undergoing some key development challenges, such as the reconstruction of countries in turmoil, the diversification of resource-dependent economies, and the rebuilding of ailing infrastructure. China is eager to cooperate on all these aspects, and the BRI provides a platform to do so.

Second, at a time when Western countries are retreating into protectionist, nationalist rhetoric, the initiative adopts the values of openness and equality. This applies on many fronts. For instance, China’s economy...
is transitioning from a period of high-speed growth, where it relies on investment and exports, to a period of high-quality growth, driven by consumption. In 2017, the contribution of consumption to GDP reached 58.8 percent. Given its open policy, China is keen on import- ing essential goods to meet the needs of its people. This large market of more than 1.3 billion people is certainly attractive to MENA countries.

Third, in parts of the developing world that suffer from a lack of funds and technical expertise, China has put forward the idea of production capacity cooperation, whereby it hopes to provide technical and financial support to other countries. This is not, as misleading media reports have alleged, an attempt to export obsolete, polluting, and backward industries. The aim is to cooperate on mature industries that have reached saturation in China. For instance, China’s “Jushi” company has invested more than $500 million in Egypt to build the third largest glass-fiber factory in the world, with an annual output of up to 200,000 tons. This project has increased Egypt's exports and also created more than 2000 jobs.

China and Arab countries have long enjoyed a strong relationship. Bilateral economic cooperation between them is bound to expand and to become more comprehensive with the advent of the BRI. As China plans to open to the West, and Arab countries are “looking East,” both will surely work together toward further and better cooperation in the future.

Discussion

The discussion mirrored Yang and Zoubir’s thoughts, noting that China’s initiative is very welcome in MENA, first because it emphasizes economic development, and second because it is not aimed at military expansion. But as China seeks to integrate MENA into the BRI, it will have to deal with a region full of countries in turmoil (such as Syria, Yemen, and Libya), transformation (such as Tunisia and GCC states), and transition (such as Saudi Arabia), and transition (such as Tunisia and GCC states).

One participant noted that there are two main sources of conflict in MENA: the Iran-Saudi rivalry and terrorism. China should continue its noninterventionist approach to the region, emphasizing development and peace in dealing with those two main issues, while also helping to advance China’s military presence in the region with the advent of the BRI. The conversation further delved into the history of the silk road, arguing that it left behind a Muslim trade network that can be leveraged for the benefit of the BRI today. Moving forward, participants emphasized the importance of developing a common legal infrastructure of arbitration—extending into finance and infrastructure—in order to harmonize procedures across China and the Islamic world. Four areas of promising cooperation between China and MENA were identified: energy, industrialization, infrastructure development, and finance. There was a consensus that China’s efforts to put an end to the conflicts that are obstructing these ties should be based on international cooperation and mediation.

The BRI and Infrastructure Development in MENA

Whether through the Red Sea project, the expansion of Oman’s Duqm port, or Turkey’s middle corridor initiative, BRI infrastructure projects are already scattered across MENA, promising to facilitate economic integration and boost growth. Contrary to development funding by Western nations, which tends to emphasize concepts such as governance, women’s empowerment, and poverty reduction, China’s development model relies on infrastructure investments in roads, railways, and airports as a foundation for growth. Through expanding infrastructure development along the BRI, China plans to roll out its domestic development model along Eurasia and Africa in an effort to contribute to worldwide growth.

Speakers: Nader Kabbani, Director of Research and Senior Fellow at the Brookings Doha Center; and Wang Zhen, Secretary of the Center of West Asia and North Africa Studies at the Shanghai Academy of Social Sciences.
region as a corridor should serve as a wakeup call to all Arab governments. If they cannot resolve domestic and regional disagreements more effectively and facilitate real collaboration, they risk being left behind in an increasingly integrated and globalized world. The region has to end the political standoff in the Gulf, begin the process of reconciliation and recovery in Syria, Libya and Yemen, and work toward longer-term stability in Iraq and Palestine. China and Europe can help nudge the region toward peace and prosperity. But, the impetus for change must come from within the region itself.

Second, the Arab region needs to think beyond the mega-projects that are currently capturing the imagination of its leadership, such as Egypt’s new capital and Saudi Arabia’s Neom economic zone. It is important to nurture local markets and link them to larger projects, infrastructure development, and trade facilitation. Simply connecting underserved areas to highway and railroad networks does not mean that they will be able to take advantage of such networks. This was the problem with the Hambantota port in Sri Lanka. There needs to be simultaneous investment in local industries and development projects that can enhance the integration of Arab economies to the BRI through increased trade and purchasing power.

Third, Arab countries need to address a persistent governance deficit at both the country and regional levels. China’s 2016 Arab Policy Paper is committed to a win-win strategy and win-win cooperation. Arab countries need to articulate what a “win” looks like for them. In its leadership, such as Egypt’s new capital and Saudi Arabia’s Neom economic zone. It is important to nurture local markets and link them to larger projects, infrastructure development, and trade facilitation. Simply connecting underserved areas to highway and railroad networks does not mean that they will be able to take advantage of such networks. This was the problem with the Hambantota port in Sri Lanka. There needs to be simultaneous investment in local industries and development projects that can enhance the integration of Arab economies to the BRI through increased trade and purchasing power.

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The BRI, however, is not without potential risks, which can be summarized in the following two aspects. The first is related to the financial risks of infrastructure investment. Foreign aid used to be the only means for China’s infrastructure investment in developing countries. Over recent years, a combination of foreign aid and commercial financing has been introduced to ease the fiscal strain of large-scale infrastructure investment. Yet, commercial financing tends to put both investors and contractors into a dilemma, with the former being concerned about investment return and the latter being worried about debt burden. This has led some in the Western media to accuse China of a “neo-colonial” agenda in places like Africa, accusations that are biased and groundless. China’s development over the past years has been fueled by government-led infrastructure investment. The country could not have achieved such great achievements if it had been entrapped by these risks.

The second is related to the security risks in invested countries. Infrastructure investment is characterized by high start-up costs and long payback periods. The potential returns can be realized only if the countries can provide a secure environment.

Discussion

During the discussion, the participants warned that while infrastructure is important, it is expensive and therefore very risky, especially given the low savings rates observed throughout MENA. For infrastructure projects to be affordable, they would have to be pursued alongside investments in productive sectors such as agriculture and industry, to ensure that countries can afford them. As such, infrastructure investment in MENA should be part of a more comprehensive plan that is realistic about the region’s financial abilities and seeks to enhance its productive capacity.

Building on Kabbani’s contribution, the conversation noted that corruption, lack of preparation, and bad governance can lead to the construction of useless infrastructure projects. Consequently, there has to be proper buy-in and planning from the countries of the region. Infrastructure projects should be purposeful and aimed at international and regional economic integration. In other words, infrastructure investment undertaken in MENA under the BRI would have to be integrated into China’s global value chain.

Moreover, unlike the Chinese model, most MENA countries have already embarked on reforms aimed at strengthening and empowering their private sectors.

China should therefore not partner only with governments in the region. If done correctly, the private sector can play a key role in avoiding the issues that come with bad governance and corruption in the region, while also providing an additional source of financing.
Given the recent fall in oil prices, energy-exporting MENA countries have revamped their diversification plans. Yet, China’s trade with MENA continues to be heavily skewed toward energy, with energy products going one way and manufactured goods going the other. The BRI presents an opportunity for cooperation beyond energy. But the BRI’s success requires ensuring that economic cooperation is sustainable, the benefits of trade are widely shared, and that BRI projects support MENA objectives and the broader integration of the region into the world economy.  

Speakers: Raed Safadi, Executive Director at the Department of Economic Development of Dubai and former Deputy Director of the Trade and Agriculture Directorate of the Ministry of Commerce in China. 

Moving beyond energy in the GCC 

Raed Safadi

What is it that China hopes to achieve through the BRI, specifically with regard to GCC countries? And, to what extent does the BRI support ongoing development and diversification plans in the GCC? Deeper Sino-GCC cooperation is likely to be driven by the GCC’s current need for economic diversification. 

Deepen Sino-GCC cooperation in trade and investment has the potential to boost economic development and diversification plans for all concerned parties. However, the potential benefits are not automatic and require not just hard infrastructure but also infrastructure of the soft kind, including, most importantly, broader institutional arrangements, both within the region and between the GCC and China. Indeed, a strong institutional arrangement within the GCC is needed to deepen engagement with the BRI.

The short-term aims of the BRI appear to be focused on offsetting higher domestic production costs and excess capacity and creating new market opportunities for China’s goods and services. This risks sustaining the solid, though shallow, structure of bilateral trade ties that so far have been limited to trade in energy products going one way, and manufactured goods going the other.

China’s remarkable economic development during the last three decades has transformed it from a net exporter of oil to the world’s largest importer. In 2017, China imported $162.2 billion worth of crude oil, $20.5 billion of which originated from Saudi Arabia (the second-largest supplier after Russia), Iraq (4th), Oman (5th), Kuwait (6th) and the UAE (10th). A natural extension of this solid, energy-intensive cooperation is to move into energy-intensive byproducts, such as petrochemicals, fertilizers, copper, iron and steel, and, more importantly, into high-technology-related services. The BRI could also provide a path toward enhanced cooperation and investments in renewable energy. This is in line with the current national visions of GCC countries, whereby each is planning to invest heavily in cleaner sources of energy. Plans are also underway in the GCC to expand energy infrastructure with an estimated $564 billion project pipeline. The BRI includes similar plans to build gas and oil pipelines. Thus, a deeper and more institutionalized form of cooperation could start with facilities connectivity between GCC investments in countries along the BRI routes and Chinese investments in GCC countries. Facilitation and protection of two-way or joint FDI—between the GCC and China or from them into third countries—are key aspects to put in place to enhance such investments.

Trade in goods and services represents another facet where a deeper form of cooperation between the two sides offers high potential returns. Policy changes are needed to induce structural transformation in the current Sino-GCC trade relationship described earlier. For the GCC, enhancing competitiveness requires deepening regional cooperation, including in such areas as competition, foreign investment laws, and incentives granted to foreign investors; commercial laws governing ownership of companies and properties; shipping and movement of cargo; aviation and air transport; and banking and finance.

For China, the GCC’s geographic location and the aviation, maritime, and logistical facilities that the region boasts provide an ideal hub to reach the wider Middle Eastern, African, and European markets. The Middle Eastern, African, and European markets. The GCC could also play a significant role in facilitating cooperation between Chinese state-owned enterprises and those in the GCC in matters concerning investment rights and obligations, transparency of regulations, and also, importantly, to promote the internationalization of small and medium enterprises from both parties. The framework could also establish mechanisms for capacity building and technical and technological exchange and upgrading. Such a framework could go a long way in paving the way for a prospective free trade agreement (FTA) to materialize and benefit both parties. Importantly, the framework could actually serve to allay some of the negotiating partners’ concerns and may help in the speedier conclusion and smoother implementation of an FTA.

China’s pursuit of FTAs 

Yueyin Bi

Since it joined the World Trade Organization in 2001, China started opening up to the outside world at a more accelerated pace. While actively participating in and promoting the global multilateral trade system, China also began to explore regional economic integration. The Chinese government started pursuing FTAs as a platform to open up to the outside and speed up domestic reforms. Through its FTA strategy, China aimed to gradually foster a high standard, globally-oriented FTA network that starts from its neighboring countries and extends to BRI regions and beyond. By the time the 17th Communist Party of China’s (CPC) National Congress was held in 2007, China had put forward a national strategy to implement numerous FTAs. Between 2008 and 2011, China concluded five FTAs with countries like New Zealand, Singapore, Peru, and Costa Rica, in addition to establishing the Economic Cooperation Framework Agreement (ECFA) with Taiwan. At the 18th CPC National Congress in 2012, and despite rising global protectionism and difficult negotiations around the Trans-Pacific Partnership (TPP) and Transatlantic Trade and Investment Partnership (TTIP), China set out to further accelerate its FTA strategy. From 2013 to 2017, it signed six FTAs and started negotiations on numerous others. By the end of 2017, China had signed 16 FTAs, involving 24 countries and regions spread across Asia, Europe, the Americas, and Oceania.

At the moment, China is in the process of negotiating seven FTAs, including with the GCC. Japan and South Korea (also known as the CJK FTA), and between the ten Association of Southeast Asian Nations (ASEAN) countries and Australia, India, Japan, South Korea, and New Zealand (under the Regional Comprehensive Economic Partnership, or RCEP). Furthermore, it is considering 10 other FTAs with four Asian countries, one European country, two African countries, one African country, and two countries in the Americas. In MENA, the Chinese FTA strategy has primarily targeted the GCC. In July 2004, China and the GCC an-
nounced the launch of China-GCC FTA negotiations. Since then, the two parties have held nine rounds of negotiations. The latest round was held in 2016, when both sides conducted substantial discussions on several leftover problems such as service trade, investment, e-commerce, and trade, concluding negotiations on chapters such as economic and technical cooperation. So far, the two sides have finalized discussions concerning nine out of fifteen key topics. They are approaching agreements on the contents of a few key topics such as technical barriers to trade (TBT), law, and e-commerce; they are also making positive progress on trading core goods and services. However, the expected tenth round of negotiation did not come through in 2017.

The China-GCC FTA has great economic potential. First, the cancellation of tariff and non-tariff barriers will help expand the scale of trade in goods between both sides. Secondly, the elimination of investment barriers would help optimize the two-way investment potential. Thirdly, the relaxation of market access to some industries will help both sides strengthen cooperation on oil, gas, and petrochemical industries.

But there are still many difficulties that are impeding the materialization of an FTA between China and the GCC. For example, some challenges have emerged on matters such as the elimination of tariffs on oil, gas, and petrochemical products coming to China, opening access to domestic oil and gas markets in the GCC, and some regional political and security issues. To overcome these difficulties, China will have to improve the competitiveness of its petrochemical industry and incorporate it under open compensation measures targeting sensitive industries in order to provide a better basis for eliminating tariffs on oil and gas products. Meanwhile, the GCC countries would also have to make some compromises, allowing Chinese enterprises better access to their domestic oil and gas industries. Only then would the two sides be able to reach an open, inclusive, and balanced high-level FTA.

Discussion

The discussion delved into the kinds of agreements that can and have been pursued with countries in the region. One participant argued that, in the face of the failure of most regional organizations in MENA to facilitate and achieve economic integration and cooperation, China should seek bilateral trade agreements with individual countries, starting with smaller economies and cross-border e-commerce. Another participant noted that MENA states tend to be highly suspicious of FTAs and have often refused to implement them despite detailed studies and assessments indicating that they could have a positive impact on both parties involved. This has particularly been the case with FTA negotiations that took place between the EU and North African countries. China would have to carefully assess what went wrong with those negotiations, particularly with the EU which tends to seek more comprehensive FTAs than the United States and has therefore been less successful than the latter in securing them with MENA countries.

The participants noted the prominence of energy in China’s bilateral trade with MENA, wondering whether there are avenues for further integration in non-energy trade, particularly in light of the recent decline in oil prices. They argued for trade agreements that are more forward-looking and that go beyond energy and toward services, including digital FTAs. The development of a network of free zones can also facilitate investment between China and MENA, as long as those zones are not limited to processing exports and instead contribute to inward linkages within a country so that more inclusive job creation can be achieved. They further urged China to seek trade agreements with high-population, non-oil-exporting countries such as Egypt, which would benefit greatly from job creation and development.

Session Four

Production Capacity Cooperation and Industrialization in MENA

Decades of investment-led growth have left China with a production capacity that is unprecedented, both in its sheer scale and the speed with which it was attained. This has structurally transformed China’s economy, while creating a situation where demand for the nation’s products is less than potential supply. Exporting China’s production capacity to BRI countries could serve the twin goals of helping China reduce the surplus capacity at home while helping MENA countries to build up their industrial bases through the transfer of production equipment, technical know-how, and experience. However, to properly benefit from China’s plans MENA would have to minimize potential policy distortions and resource misallocation.

Speakers: Mustapha Nabli, President of the North Africa Bureau of Economic Studies and former Governor of the Central Bank and Minister of Planning and Regional Development in Tunisia; and Zhang Youwen, Professor at the Institute of World Economy at the Shanghai Academy of Social Sciences.

Maximizing the BRI’s potential for MENA

Excess production capacity in China is a result of a decades-long massive investment drive, where the investment-to-GDP ratio exceeded 40 percent for several decades. Achieving high levels of investment for such a large economy required developing an unprecedented and large-scale production capacity made-up of three components: the capacity to produce material inputs, to produce standardized machinery and equipment, and to implement large-scale projects.

Today, there is excess in the installed industrial capacity to produce standardized inputs which go into the production of physical assets. Overall capacity is higher than what is currently warranted by domestic and global market conditions for many products such as iron and steel, non-metal minerals, nonferrous minerals, textiles, fur and leather, paper, and chemical fibers. Similarly, China has the capacity and know-how to implement large-scale investment projects (design, construction, and supervision), in many sectors, including infrastructure, energy, real-estate, and the development, construction, and management of industrial parks.

Theoretically, there are three channels for using this production capacity in places like MENA: open trade, public project contracting, and FDI. For material inputs, MENA could be a market for outputs through open trade, supply to public projects, or supply to FDI projects. For machinery and equipment, it could be a market for outputs through open trade, supply to public projects, or through FDI projects. MENA could also be a buyer of the excess capacity of machinery and equipment for producing both material inputs and machinery and equipment. For large projects, it could be a market for mostly public projects and FDI, with bundling of procurement contracts and lending.

However, the benefits of such an exchange can only be maximized under a common development strategy in MENA. Currently, there are at least four major groupings in MENA: resource-rich low population (GCC), resource-rich large population (Iran, Algeria); resource-poor
(Egypt, Turkey, Jordan, Morocco, Tunisia, and Lebanon); and conflict-affected and reconstruction countries (Iraq, Syria, Libya, and Yemen). Each grouping faces different challenges and risks, and it is unlikely they will converge to common development strategies. The cooperation between China and MENA on the BRI will therefore likely take place in the context of bilateral relationships, which would have a limited impact on the growth strategies of countries in the region.

But let us imagine a hypothetical scenario where at least the major countries of the region (Egypt, Turkey, Iran, Algeria, and Morocco) pursue an ambitious industrialization strategy, with some features of China’s approach. This would involve an investment-driven growth strategy where a large component is in state-driven infrastructure projects and a switch toward industrialization that would support diversification in resource-rich countries and upgrade industry in resource-poor countries. If there were also to be a strong regional integration drive, there would be large potential from cooperation with China. The region would be able to implement large-scale infrastructure projects that would enable it to structure its industrialization, with Chinese state-owned enterprises (SOEs) playing a major role through joint-ventures. Through an influx of FDI, MENA would be able to build on its strategic geographic position with respect to Europe and Africa, acting as a platform for trade, production, and services.

From the MENA side, countries would need to move away from pro-cyclical fiscal policies in resource-rich countries, which constrain productive investment and impact even resource-poor countries. They would also need to increase their savings rates from their low levels, typically on the order of 15–20 percent of GDP, and enhance their capacity to finance a large investment. MENA would be able to partner and work simultaneously to manufacture the 22 parts of that large equipment, namely, excess capacity. Over the years, China has developed excess capacity across all raw materials, including large equipment, textiles, auto steel, iron, and cement. In these traditional manufacturing industries, China has excelled at minimizing costs, while maintaining adequate quality. Take the example of a lighter, which, despite consisting of 22 different parts, can be sold at 0.1 RMB (less than 2 cents). This is possible because the country boosts an incredible value chain that allows multiple factories to work simultaneously to manufacture the 22 parts of that lighter at minimal costs, driving down its price in the market. These value chains started with high-level government plans that established industrial parks, which proved. While this model works well for the kinds of defense, aerospace, urban renewal, and the industrialization of agriculture. This would be a natural transition in market-driven economies that would allow companies to go bankrupt and move on to more productive domestic industries without the need for an initiative such as the BRI to export this capacity externally.

In fact, some questioned whether Chinese excess capacity would force MENA countries into adopting outdated and obsolete capacities that are no longer profitable and fit for global demand. In response, others emphasized that China’s expansion abroad is in fact driven by market dynamics and that Chinese companies are currently looking for opportunities to regain a comparative advantage in industries that have been affected by structural changes in China, including rising wages.

Discussion

Questions were raised surrounding the nature of China’s excess capacity problem and whether it could have been avoided if China was less reliant on SOEs in industrialization. Here, participants asked whether, instead of exporting its capacity abroad, China’s excess capacity should simply be allowed to transition to more productive sectors domestically, including in industries such as defense, aerospace, urban renewal, and the industrialization of agriculture. This would be a natural transition in market-driven economies that would allow companies to go bankrupt and move on to more productive domestic industries without the need for an initiative such as the BRI to export this capacity externally.

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Given China’s reliance on SOEs to drive growth, participants raised further questions about who the main actors will be along the BRI, wondering if the private sector will be allowed a strong role in investment, and how that can be undertaken in a region like MENA, where growth has often been government-led, and where government bureaucracy and crony capitalism have often stood in the way of the development of a strong private sector. One participant argued that, if played correctly, the BRI can find a window of opportunity that avoids dealing with government bureaucracy and crony capitalism in MENA through engaging primarily with reformers and leaders, who tend to be keen on job creating initiatives that would reduce public dissent and frustration.

With local suppliers. Finally, they would need to work with a credible legal and institutional framework for partnerships and joint ventures.

Excess capacity as a comparative advantage

There is a significant transformation taking place in China today. The country has slowly been losing one of its key comparative advantages: cheap labor. Beginning in the 1980s, the Chinese economy benefited significantly from its cheap labor in attracting foreign investment. Foreign investors often came with established brands and advanced technologies. Employment soared, expertise expanded, and new, sometimes private, Chinese companies emerged to compete domestically and abroad. Today, that model is being shaken by the gradual disappearance of the demographic dividend that followed the one-child policy, a growing middle class, and rising labor costs. However, a new comparative advantage has been emerging, namely, excess capacity. Over the years, China has developed excess capacity across all raw materials, including large equipment, textiles, auto steel, iron, and cement. In these traditional manufacturing industries, China has excelled at minimizing costs, while maintaining adequate quality. Take the example of a lighter, which, despite consisting of 22 different parts, can be sold at 0.1 RMB (less than 2 cents). This is possible because the country boosts an incredible value chain that allows multiple factories to work simultaneously to manufacture the 22 parts of that lighter at minimal costs, driving down its price in the market. These value chains started with high-level government plans that established industrial parks, which provided. While this model works well for the kinds of defense, aerospace, urban renewal, and the industrialization of agriculture. This would be a natural transition in market-driven economies that would allow companies to go bankrupt and move on to more productive domestic industries without the need for an initiative such as the BRI to export this capacity externally.

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New avenues for banking and financial cooperation

Nasser Saidi

China has created an imposing array of international financial institutions to fund its BRI ambitions, while the countries and companies of MENA are bracing for the BRI to shift growth and economic diversification to a new phase. Since 2014, MENA countries have signed more than $50 billion in contracts with China. More recently, the Chinese have listed Egypt as one of the top five destinations for mergers and acquisitions activity under the BRI. The UAE (specifically Abu Dhabi Ports), in its capacity as a regional trading hub, has signed a partnership with COSCO, China’s largest shipping company, to build new terminals to support the increased flow of trade along BRI routers. Approximately 60 percent of China-UAE trade is re-exported to Africa or Europe, which will support the BRI’s purpose, while making the UAE (and particularly Dubai) an important component of China’s trade strategy in MENA and beyond.

The strong presence of Chinese banks in the GCC provides the financial underpinning for deeper and wider linkages. Banks in MENA should make use of this opportunity to provide co-financing for BRI countries, as well as to push for public/private co-financing of BRI projects, thereby bringing MENA closer to China. The GCC banking sector has to pivot East over the coming decades accompanying the shift of economic geography.

As the BRI takes shape, the GCC countries can partner with China to drive greater economic diversification through privatization and public-private partnerships. China’s project finance in MENA has mostly been in energy and natural resources, similar to investments in other BRI countries. However, there is a massive opportunity, as many countries along the BRI need to improve their infrastructure stock. This is an opportunity for Chinese and GCC sovereign wealth funds (SWFs) to partner, co-invest, and co-finance investments in the BRI countries. Similarly, MENA and GCC countries should also build on China’s growing leadership in renewable energy (notably solar), robotics, artificial intelligence, and FinTech to diversify their economies and participate in the Fourth Industrial Revolution.

The BRI and the diversification of financial risks

Ding YiFan

China and the oil-producing countries in MENA are net capital exporters. The combined sovereign wealth funds of China and MENA countries account for about 70 percent of the world’s total sovereign wealth funds. Much of this capital is held in and transacted through other currencies, either the dollar or the euro. Historically, when Britain was the world’s largest net capital exporter, it relied on the British currency. When the United States became the largest net capital exporter, it did the same in dollars, allowing it overtime to become the currency of choice for capital transactions.

China and MENA’s capital exporters rely heavily on the dollar and euro for their investments abroad despite the many risks this entails. First, those countries must contend with the risk of a currency mismatch. Investing in foreign currencies presents a high risk because the values of these currencies are under influenced by the central banks of other countries. Using foreign currencies for offshore investment can therefore lead to mismatches of large amounts of debts, which can be burdensome.

Secondly, the value of foreign currencies can become unstable. For instance, the instability of the euro became clear following Europe’s debt crisis, which started in Greece and spread to Ireland, Portugal, Spain, and Italy. While the euro has stabilized, and Europe’s debt situation has slowly improved, other risks persist in the eurozone. For instance, populism is rising in Europe and its leaders are increasingly opposed to the euro and the EU. If Europe’s monetary system came under heavy political pressures, this would create further risks for the capital-exporting countries.

The dollar’s prospects are similarly worrisome over the medium to long term. President Donald Trump has decided to cut taxes and run large deficits. As the resulting rise in debt begins to threaten fiscal stability in the United States, the value of investments held by China and MENA capital exporters could be eroded by a combination of inflation, dollar depreciation, or both.

Capital-exporting states must develop the financial tools that can help reduce their exposure to these risks. When the United States replaced the United Kingdom as the largest crude oil importer, it created an oil futures market in New York. As the largest crude oil importer, China is naturally now building a RMB crude oil futures market in Shanghai. Additionally, there are very important RMB offshore markets in London, Hong Kong, and most European financial centers, such as Paris, Frankfurt, Luxemburg, Zurich, and other cities. These provide new opportunities for cooperation between China and oil-producing MENA countries, whereby MENA can join RMB-denominated financing mechanisms. Of course, the investment of RMB in London will be easier than in Shanghai because China still partially maintains capital control, and countries may also use RMB to issue bonds in Hong Kong and London.
Finally, China and oil-producing MENA states should arrange some currency swaps. In the past, EU countries traded with China either through the dollar or the euro. But when France’s BNP-Paribas bank and Germany’s Deutsche Bank were sanctioned by the United States for allegedly violating the financial sanctions against Iran, EU countries subsequently gave up the use of the dollar in their bilateral trade with China. Currently, bilateral trade settlements between European countries and China use the euro and RMB almost equally. As a result, growing levels of the RMB have been accumulating in the European offshore market, and RMB-denominated bonds can be easily issued in Europe. These conditions are favorable to promoting cooperation between China and MENA that can aim for greater balance in the global financial system by using specific and practical methods.

**Discussion**

The discussion emphasized that the Arab world and China do not lack funds, but that most money is being recycled in the U.S. and EU financial systems. The region—and China—should promote local financial institutions and investment funds and extend them internationally. Under the BRI, the financial institutions of both sides can come together, bilateral swaps can increase, and risky foreign exchanges can be avoided—perhaps through making more transactions using local currencies or Special Drawing Rights (SDRs).

Participants discussed reasons why SWFs in MENA tend to invest outside the region, noting the region’s low investment opportunities and returns. They argued that the BRI can ideally serve to improve the rates of returns and reduce risks through economic growth, increased integration, and placing the region within the global value chain. But it is only by contributing to real economic growth in the region that financial cooperation will be feasible. The lack of effective regional financial institutions in MENA complicate BRI investments and hinder joint financial mechanisms with China, creating incentives for money to flow outside the region instead of within it.

Furthermore, the participants noted that risks associated with money and finance are indirectly a function of trust and soft power. Ties between MENA and China lack effective channels for cultural exchange similar to the kind of exchange that took place along the silk road in the past. In essence, the BRI will not be successful if it relies solely on economic ties such as trade, energy, currency exchange, etc. The exchange of people, culture, ideas, and mutual understanding is necessary to facilitate financial integration and cooperation.

For decades MENA has been a strategic energy partner for China. This partnership is being challenged by structural changes and technological breakthroughs that are transforming international energy markets. Power grids, solar plants, and green energy projects are all emerging along the BRI routes, making the transition away from conventional energy sources more possible. Far from resisting this transition, MENA countries have already shown signs of embracing it. The BRI’s energy strategy and ongoing technological innovations will have some important implications for the dynamics of energy trade between China and MENA.

**Toward deeper partnership that transcends energy**

**Ibrahim Saif**

Energy has been a pillar of the relationship between China and MENA. China has been one of the largest consumers of energy-related products, while MENA has been the largest producer and exporter. Until recently, this had dictated the dynamics between the two sides and shaped their perceived interests. MENA’s main concern has been to maintain the security of supply routes and trade, while China has been keen on bolstering stability in exporting countries to ensure the regular supply of energy. Other forms of cooperation have evolved from energy and related activities, leading to growth in trade and investment between China and MENA, but those activities have been limited to a set of products and sectors that are inconsequential to deeper integration.

However, over the past few years, a few developments both in MENA and in China might have paved the way for a new dynamic. The “Arab Spring” resulted in a wave of instability that threatened the very existence of some countries and set them down highly uncertain paths. Countries that have survived the Arab Spring have opted to build new alliances with some emerging and growing economies, such as China, in an attempt to enhance their resilience. As hydrocarbon prices dropped, MENA countries, especially in the Gulf Region, have renewed their efforts to diversify their economies away from hydrocarbons, creating yet another incentive for more economic cooperation with China. On the Chinese side, the government and its leaders adopted a strategic shift toward more direct investment and deeper integration with major trade partners. Therefore, one could argue that China and the energy-exporting countries of MENA have been joined by common objectives: to invest in the stability and sustainability of key trade partners.

The BRI identifies the energy sector as a key sector that could lead cooperation. Yet, this underplays the fact that, with the aforementioned objectives in mind, the relationship between MENA and China can be
extended beyond this traditional framework for several reasons. First, the resources that are available are huge, including financial and technical resources and opportunities that are readily available both in MENA and China. For instance, strong opportunities exist in infrastructure and upstream and downstream industries, which can cater to the significant global demand in those sectors. Second, the business environment, especially in the GCC countries, has improved and moved toward more openness and heightened interest in quality FDI and partnerships with countries such as China. Third, under the BRI, there is a clear strategy on the Chinese side that can further cooperation. Similarly, most stable MENA countries have adopted long-term visions that can be squared with the BRI in order to draw future scenarios and identify specific investment opportunities. These constitute promising success factors that can enhance cooperation as long as continuous dialogue is held to overcome any difficulties and reach a common understanding. Ultimately, both sides have the desire to forge a deeper strategic partnership that moves beyond energy and serves the interests of all sides involved.

Coincidentally, recent developments in technology, especially relating to clean and renewable energy, are going to alter the structure of supply and demand globally over the next decade or so, presenting a new avenue for deeper partnership. This will require agility on both the demand and supply side in order to be able to adapt to and adopt the emerging technologies. On the energy producing side, MENA countries must consider new products and new markets and must prepare themselves for a rapidly changing demand structure. They need to be more aggressive in pursuing policies that help diversify their economies and exploit more resources. On the Chinese side, investments should target sectors that would enhance stability and diversification because that would enhance long run stability and sustainability.

Successful partnerships between countries are based on mutual interests and clear visions. While the visions are clear, it is important for countries to translate these visions into action plans with regular evaluation and revision in order to guarantee successful, mutually beneficial cooperation.

The importance of MENA energy to China
Pan Guang

The geopolitical and internal upheaval in MENA over the past few years has not shaken energy cooperation between China and the hydrocarbon-exporting nations in the region significantly, although it has affected some key trade routes—namely the “Maritime Silk Road” between China and those nations. MENA remains critical to China’s energy security. In 2017, China imported about 8.4 million barrels of oil per day, 3.9 million of which came from MENA. Saudi Arabia was the largest exporter from the region followed by Iraq, Oman, Iran, Kuwait and the UAE. At the same time, Qatar was China’s largest exporter of liquefied natural gas in 2016.

China’s thriving economy has propelled it past the United States as the world’s largest net oil importer. At a time when the United States continues to demonstrate a preference for non-Arab sources of oil, the bond between Arab oil-producing nations and Chinese companies has only strengthened. For instance, in January 2016, President Xi announced the establishment of the Yasref petrochemical refinery during his visit to Saudi Arabia, a project that characterizes the new era of China-Middle East energy cooperation, where trade goes hand-in-hand with mutual investment. Similarly, despite its struggling security situation, China has been importing increasing amounts of oil from Iraq and initiated several oil-related joint ventures with the country. Meanwhile, discussions are advancing with China to increase its investments in Jordan’s industrial and energy sectors.

This demonstrates China’s propensity to be open to some security risks that many countries would avoid, making it an important partner for MENA. Yet there are tangible costs to the kind of instability that has featured in MENA in recent years. Transportation and insurance prices have increased, propelling many Chinese companies to stop transporting goods to war-torn countries like Libya, Syria, Yemen, and some places in Iraq. Transportation from MENA is also almost exclusively conducted via ships, which can be dangerous on some routes that are affected by piracy. To balance these risks and avoid over-dependence on MENA energy, China will continue to seek and secure more sources of energy overseas and to establish transportation channels other than those in or connected to MENA. Particularly, Central Asia—Russia—China energy pipelines are now playing an increasingly important role in Chinese energy security.

However, MENA’s primary role in China’s overall overseas energy development strategy is irreplaceable, at least for the near future. Given the growing geopolitical dislocation in the international system, this will surely result in a change in China’s MENA policy, propelling China to take a more active role in the political and economic affairs of the region. Reflecting this shift, China pledged a package of $20 billion in loans to MENA countries in June 2018, as part of what President Xi called an “oil and gas plus” model to revive economic growth in the region.

Moreover, in an effort to maintain its stable and friendly relations with MENA countries, it is now more likely than ever that China will step up its role in the region and act as a diplomatic mediator in an attempt to resolve certain longstanding conflicts in MENA. About $100 million in aid was pledged in 2018 to Jordan, Lebanon, Syria, and Yemen. This role will be resisted by the United States and Europe, whose ability to play a constructive role in MENA’s affairs is either shrinking or losing impact.

Discussion

The discussion highlighted how the energy relationship between China and MENA is likely to evolve over time. The United States will soon become a net energy exporter, while China remains hesitant about tapping its shale reserves. This will increase the importance of China as an energy importer for MENA in the future. However, demand and supply forces are changing the value of MENA’s energy in the world economy overall. On the demand side, greater energy efficiency, heightened environmental awareness, and new technologies are gradually reducing consumption of conventional energy. On the supply side, advances in shale and renewable energy technologies are introducing powerful competitors to the global energy market. Over the next decades, MENA oil-exporting countries will therefore have to find a way to both maintain China as a key energy importer and to diversify their economies to make up for falling prices. Another important feature of energy cooperation between MENA and China is energy security; both the security of energy imports from the perspective of China and the security of energy exports from the MENA perspective. China is interested in gaining more access to the upstream MENA energy market both to ensure the security of its oil supply and to create more business opportunities for Chinese oil companies. On the other hand, oil-exporting countries want to gain the Chinese market in the face of high competition. As the BRI unfolds, energy-exporting MENA countries may find it advantageous to open up their upstream hydrocarbon production to Chinese business firms, while the Chinese open up downstream hydrocarbon production, such as refineries, petrochemical industries, storage and transportation sectors, to MENA businesses. This would allow those MENA countries to increase their investments and to better secure their future market, putting them in a stronger, more competitive position and helping them stand out among competitors.