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The Development of the Sino-Iranian Limited Partnership: China's $600-Billion Proposition

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The Joint Comprehensive Plan of Action (JCPOA), signed by the U.S., Iran, and other countries in July 2015, addressed concerns about Iran's nuclear program in exchange for lifting most sanctions. During the P5+1 talks, China played a key role in arbitrating between the U.S. and Iran and persuading Iran of the potential economic benefits of re-entering the global economy and increasing ties with China. After the implementation of the JCPOA, Chinese President Xi Jinping went on a three-country Middle East diplomatic tour, including a historic visit to Tehran to meet with President Hassan Rouhani and Supreme Leader Ayatollah Ali Khamenei on January 22-23, 2016. During the trip, both Iranian and Chinese leaders called for strengthening their "strategic partnership" and economic cooperation, with Xi and Rouhani announcing a planned 10-year $600-billion bilateral trade deal: "Today we discussed the strategic relationship between both countries, setting up a comprehensive 25-year plan and also promoting bilateral relations of up to $600 billion over the next 10 years." Khamenei voiced his support for the strengthening of ties stating, "Iranians never trusted the West…. That's why Tehran seeks cooperation with more independent countries like China."

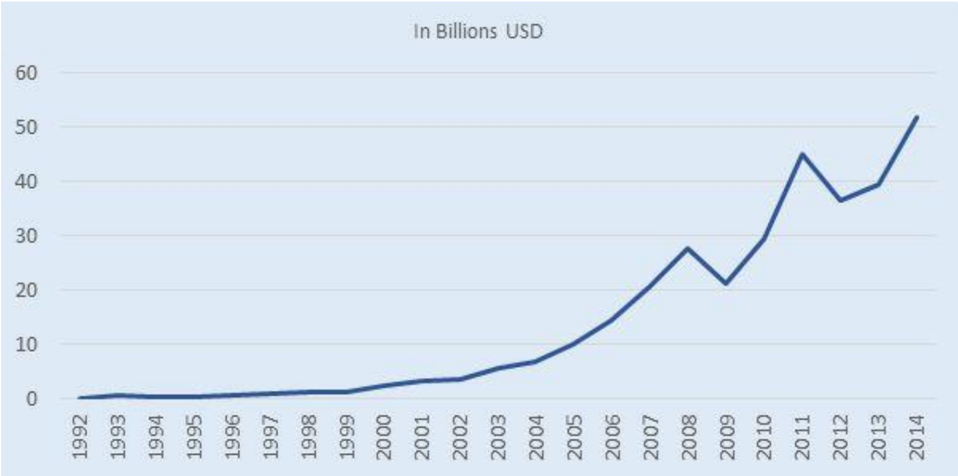
These developments have raised fears that increasing Sino-Iranian geopolitical and economic cooperation could challenge U.S. hegemony in the region and that China could also emerge as the primary benefactor from the lifting of sanctions. While China's proposal to increase bilateral trade with Iran over the next ten years by $600 billion, a 10-fold jump, is impressive, it raises many questions about its feasibility for both countries and the actual degree of implementation. Even if the aggregate investment does not reach $600 billion, this proposal signals a significant effort by the Chinese to increase their economic and geopolitical leverage in Tehran.

History of Sino-Iranian Economic Relations

China and Iran are the modern heirs of two ancient eastern civilizations that have each at times dominated Asia, and this history continues to shape their interactions with each other and the world, as well as their national identities and ambitions. Modern Iran and China espouse a narrative of a long history of friendship—and a shared history of oppression by Western imperialism. Both powers use this to challenge Western leadership of the international community, which accuses them of human rights violations, freedom of speech restrictions, and general anti-democratic policies, among others. In *China and Iran: Ancient Partners in a Post-Imperial World*, John Garver explains that Chinese alignment with Iran has, however, been driven by pragmatism; it was "not free-floating civilizational solidarities [that] primarily motivated Beijing and Tehran to cooperate." Thus, the Sino-Iranian relationship can be categorized as a "limited partnership."

In 1978 and 1979 both countries faced pivotal moments, during Ayatollah Khomeini's Iranian Revolution and Deng Xiaoping's economic reforms. In the 1980s, bilateral trade rose to $400 million annually; however, China continued to play a "dual game," improving economic relations with the U.S. while also increasing purchases of Iranian oil. In addition, while China sold arms to Iran during the Iran-Iraq War (1980-1988), the People's Republic of China (PRC) ended its support for the Iranian missile and nuclear weapons programs in 1997.

China-Iran Bilateral Trade



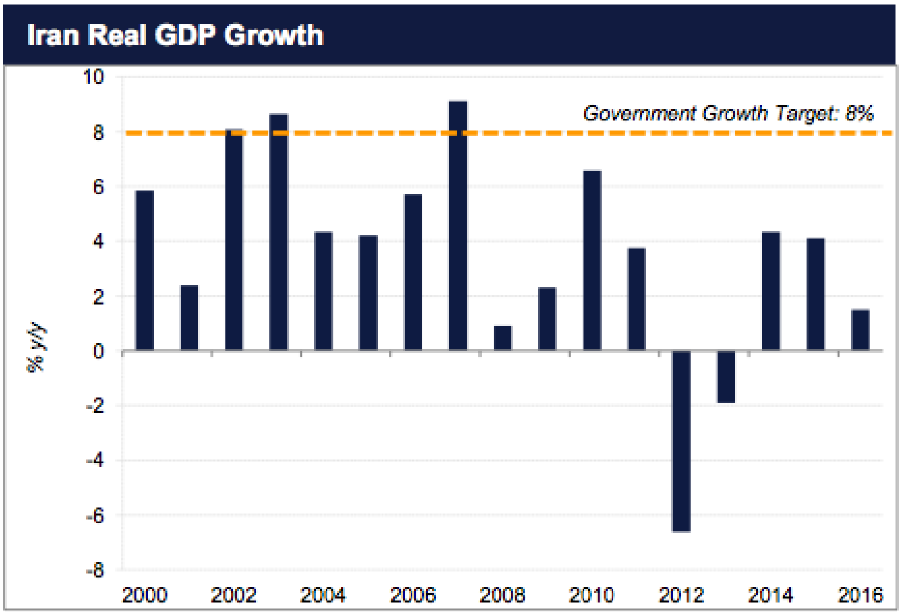
Source: Scott, "Defying Expectations China's Iran Trade and Investments"

Through the end of the twentieth century and first decade of the twenty-first, trade between the two countries continued to rise, despite increasingly restrictive international sanctions. By 2007, China had become Iran's top trading partner, and between 2000 and 2011, Iranian oil exports to China increased by 25 percent. In 2011, President Ahmandinejad called for trade with China to increase from $30 billion to $100 billion annually. Despite these expanding trade relations, China still did not want its Iranian ties to damage its relationship with the U.S., and for good reason: its average annual sale of goods and services to the U.S. in 2012 was $399 billion and grew to $483 billion in 2015, almost ten times the level of its highest annual total trade with Iran. During the strictest sanctions in 2012, China cut its purchase of Iranian oil, fearing the repercussions of secondary sanctions by the U.S. for dealing with the "rogue state." China continued to curtail its oil purchases until the November 2013 interim nuclear accord, after which imports returned to pre-2012 levels; however, it maintained several economic development projects in Iran during this period. By 2014, Sino-Iranian bilateral trade had risen to $51.8 billion, marking a $29.4 billion increase between 2010 and 2014, half of Ahmadinejad's proposed $100 billion increase, but still a small fraction of China's overall trade with the U.S.

Iranian-Chinese Trade and FDI Trends

Many doubt whether the $600-billion proposed bilateral trade agreement will actually be fulfilled. If, however, it is, it would be a very significant injection of Chinese capital into the Iranian economy: an average of $60 billion annually would be approximately

15 percent of Iran's GDP ($393.7 billion in 2015). In recent years, Iran has experienced unstable GDP growth, after a downturn of about 7 percent in 2012 and only 0.5 percent growth in the 2015, despite the anticipated economic benefits of the JCPOA agreement. In January 2016, the World Bank predicted the Iranian economy would grow by 5.8 to 6.7 percent in 2016-2017, while Mohammad Nahavandian, Rouhani's chief of staff, believes "8 percent is feasible." Emirates NBD senior economist Jean-Paul Pigat asserted that while unlikely, it is possible for Iran to reach 8 percent growth because it has hit that mark on three separate occasions since 2000 (2002, 2003, 2007). While this forecast of 8 percent growth might be too optimistic, it is still probable that there will be an overall GDP increase in Iran during the next ten years.



Source: Pigat, "Iran FDI Update"

Since the JCPOA implementation in January 2016, there has been a dramatic increase in Foreign Direct Investment (FDI) projects in Iran. Although new FDI projects rose from three in 2013 to eight in 2014, and nine in 2015, in the first quarter of 2016, there were 22, more than the total of the three previous years combined. Foreign investment come from several countries, with South Korea and Germany leading the first quarter of 2016, with a combined $2.15 billion committed. In addition, since the JCPOA, Iran has finalized its purchase of a 2.8 percent share in the Chinese-led Asian Infrastructure Investment Bank (AIIB), which promotes development projects throughout Asia. Emma Scott, however, has raised doubts about China's long-term commitment to FDI in Iran. She notes that in 2011, Iran ranked 12 in Chinese foreign investment flows at $615 million, but by 2014 its ranking had dropped to 22 at $600 million. For now the spigot of foreign investment has opened, but it remains to be seen how and to what extent it will remain open, as well as the extent of China's desire to lead FDI in Iran.

Recent FDI Projects in Iran

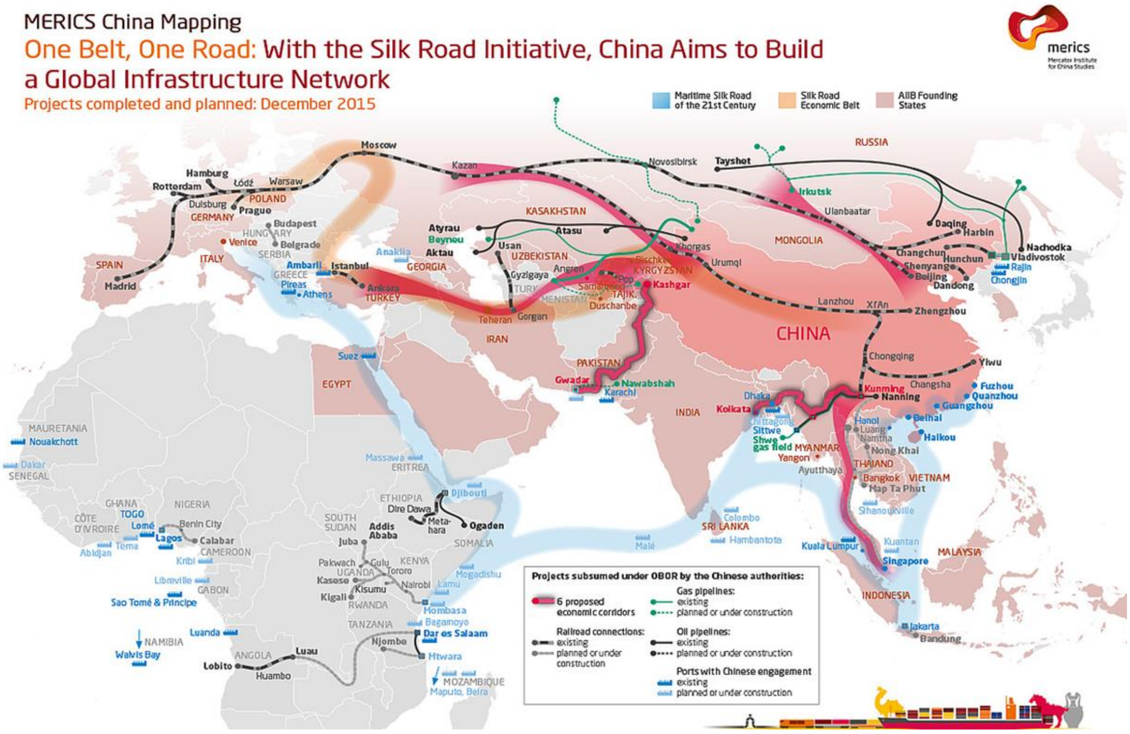
	Projects	Capex $m	Jobs
Q1 2016	22	3,489	4376
2015	9	2,473	541
2014	8	1,670	2732
2013	3	79	352

Source: Cara Lyttle, "FDI in Iran soars with sanctions relief"

In the wake of the JCPOA, many theorized that developed countries and global corporations would rush to invest in Iran; however, this has been only partially true. Despite the agreement, many Western companies fear they could risk violating the remaining sanctions, and if the JCPOA snapback sanctions provision were enacted, staying in the country would entail huge fines. In addition, the U.S. continues to limit Iran's connections to the global financial markets because it prevents businesses in Iran from using U.S. dollars. Clearly, there are still many barriers to rapid expansion of Chinese or other foreign investment in Iran.

The One Belt, One Road Initiative

Macro-level developments in China's economic policy will also affect its relationship with Iran, and all of Asia. In 2013, President Xi announced the "One Belt, One Road" initiative, which seeks to encourage the development of former Silk Road countries so as to build trade routes for China between Asia and Europe and create a modern counterpart to the ancient route. China plans to connect these countries further by pursuing the creation of high-speed railways through Central and West Asia, including Iran. Furthermore, China has been promoting the development of highways, subways, and ports. Many fear that China's energy, transportation, and infrastructure projects along the trade routes signal its intention to influence the geopolitics of those regions. President Xi has stressed non-interference; however, this has done little to assuage fears of Chinese hegemony.



These Chinese plans, if implemented, could significantly benefit Iran's economic development. On February 15, 2015, President Rouhani voiced Iranian support for the "One Belt, One Road" initiative, viewing the plan as mutually beneficial. At an economic seminar in China in 2015, Dr. Zhao Baige, Deputy Director of the PRC Foreign Affairs Committee, said "Iran is…one of the most crucial countries along the 'One Belt and One Road.'" Jeffrey Payne sees Chinese interest as primarily geostrategic: "The overland Silk Road cannot effectively connect the east to the west without Iran as an integrated part." While Payne does conclude that increasing bilateral ties would be difficult, through the paradigm of the "One Belt, One Road" initiative, Iran could become China's key partner in the Middle East.

Iran-China Energy Development Relationship

Chinese oil imports are expected to grow from approximately 6 million barrels per day presently to 13 million by 2035, and Iran holds the fourth largest global oil reserves and second largest natural gas reserves. Joel Wuthnow asserts that over the last 20 years China has pursued a strategy of energy diversification to reduce the risk of relying too much on one state, and thus would be unlikely to increase dependence on Iran. Others raise the possibility that Chinese oil imports from Iran were reduced before sanctions were lifted because Beijing feared a U.S. backlash for its close relationship with Tehran, and now, after the nuclear deal, the two countries will strengthen commitments. Although a large increase in oil trade is improbable, it remains uncertain how much the JCPOA will influence Chinese policy.

Between 2006 and 2014, China continued to pursue energy projects in Iran, but these were stalled by Chinese hesitation and problems with labor, safety, and other issues. In light of the JCPOA agreement and the end of most Western sanctions, many have theorized that some Sino-Iranian energy projects will resume and the number of new projects will increase, though the scale is debated. In addition to their recent development projects of the North Azadegan and Yadavaran oil fields, SINOPEC and CNPC are expected to generally increase oil production and new projects in Iran. In fact, CNPC might even return to its development of the South Pars gas field. Furthermore, since the JCPOA, China has proposed investments and technological guidance to build two new Iranian nuclear power plants, but it faces competition from Russia, South Korea, and Japan in Iran's nuclear energy market.

Conclusion

While the JCPOA could foster closer Sino-Iranian ties in some areas, it is probable that many of the same constraints on the relationship will continue. China still cannot pursue a dramatically increased alignment with Iran as it tries to maintain its troubled but profitable economic marriage with the U.S. and its economic interests in Saudi Arabia, Israel, and Turkey. In addition, Beijing seeks to promote regional stability and non-intervention in the Middle East, which pursuing deep commitments with Iran could disrupt. Despite these factors, China will still likely increase its economic presence in Iran to some degree because it does not want to lose opportunities in its emerging markets and the economic and geopolitical leverage that could come with them. It will, however, have to limit its partnership to prevent over-reliance, minimize risk, and avoid damaging other economic relationships.

While both Rouhani and Xi promised to deepen their strategic partnership, a close geopolitical alignment is not expected. Beijing is unlikely to form a NATO-style military alliance with Tehran because China only has a limited military alliance with North Korea and none at all with Pakistan and Russia, who have far stronger ties to the

PRC than Iran. Although Iran and China may work together to oppose the U.S. on certain issues, Beijing will probably never value its relationship with Tehran more than its relationship with Washington. Regardless, even a modest increase in the geostrategic and economic cooperation between Tehran and Beijing could have significant consequences for the U.S.

Despite the JCPOA agreement and the proposed $600-billion bilateral trade deal, China's relationship with Iran will likely continue as a limited partnership because much of the same rationale for restricting their relationship still applies. While this limited partnership is likely to be maintained, the dynamics of it will probably shift in the aftermath of the JCPOA. The Sino-Iranian relationship has always been based on practicalities, especially for the Chinese; if changing economic and geopolitical conditions require a deeper commitment to Iran, China could pursue it, but for now it is playing a relatively cautious game.

Michael Schwartz is a third-year student of Modern History and Middle East Studies at the University of St Andrews (U.K.). He was an intern at the Moshe Dayan Center for Middle Eastern and African Studies (MDC) during the summer of 2016.

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