Editors: Paul Rivlin and Joel D. Parker

Vol. 9, No. 3, Mach 28, 2019

China: Economy, Energy and the Middle East

Paul Rivlin

Several key questions arise with respect to China's economic involvement in the Middle East: What are China's interests in the Middle East? How far are they dominated by its energy needs? How are they affected by its relations with the United States?

Since the reforms introduced by Deng Xiaoping at the end of the 1970s, China has experienced rapid economic growth. In 2000, China's GDP was equal to 12 percent of that of the US; by 2017 it had reached 63 percent. It's GDP per capita rose from under 3 percent of the US level to nearly 15 percent in the same period. In real terms, China's GDP more than quadrupled and GDP per capita rose nearly as fast.

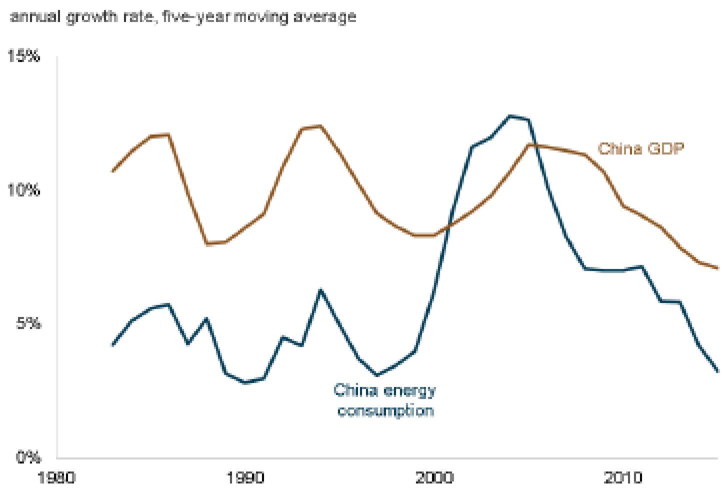
One of the main consequences of the rapid growth of what has become the world's second largest economy has been a rise in energy consumption. The growth of the economy has slowed in recent years and this reflects changes in the structure of the economy, changes in policy, as well as numerous problems.

During the last twenty years, coal, which is domestically produced, has taken a declining share of total demand and oil, which is largely imported, has taken a larger share. This is exactly what happened in the UK before First World War following the decision to build oil-powered ships for the Royal Navy. That decision had significant strategic implications, especially for Britain's presence in Iran and there is a Chinese echo to this story now. In 1993 China became a net oil importer of oil; in 2004 it became the world's second largest petroleum consumer after the United States, and by 2017 imported about 70 percent of its oil.

The slowdown in Chinese economic growth and the demand for energy is shown in Table 1. The slowdown in energy demand was also due to structural reform in China's economy, tighter environmental control and development of alternative energy sources including the introduction of hybrid and electric cars.

Table 1

China: Total primary energy consumption and gross domestic product growth rates



Source: Energy Information Agency

In 2017, the International Energy Agency (IEA) made forecasts for the oil market to the year 2023, and their data suggests that Chinese demand for oil will grow at over double that of world demand (Table 2). At the same time, Chinese domestic supply is expected to fall between 2017 and 2023 by 7.7 percent. As a result, China's reliance on imports will increase. It should also be noted that China's primary competitor, the United States, is and will continue to be, the fastest growing oil producer in the world.

Table 2

IEA Forecast: World Oil Supply and Demand, 2017-2023 (mb/d)

	2017	2023	2017-2023 % change
Demand			
World	97.8	104.7	7.1
- China	12.5	14.4	15.2
Supply			
- USA	13.2	16.9	28.0
- China	3.9	3.6	-7.7
- OPEC	32.8	34.1	4.2
OPEC MENA capacity	29.6	31.3	5.8
OPEC MENA as % world demand	35.6	36.1	

Source: World Energy Outlook 2017, IEA

In 2018, the main suppliers of the crude oil imported into China were Russia (15.8%), Saudi Arabia (12.4%), Angola (10.4%), Iraq (9.4%), Oman (7.2%), Brazil (6.8%), Iran (6.3%), Kuwait (5%), Venezuela (2.9%), United States (2.8%), Congo (2.7%), Colombia (2.1%), Malaysia (2%), and Libya (2%). The Middle East and North African region accounted for nearly 50 percent of imports.[1]

The IEA has also forecast that in 2040 the Middle East will account for about half of China's oil supply and China will be the destination for about a quarter of Middle East exports. Commercial ties between the two will expand as two-way investment develops. Saudi Aramco owns part of a refinery in Fujian and is looking for investment opportunities in China's downstream (refining) sector. China is looking for opportunities to invest in the Middle East's upstream. In 2017, Abu Dhabi awarded Chinese companies 12 percent of its largest oil concession.

China's imports of liquid natural gas (LNG) will also rise, which may offer Middle East producers – Qatar, Iran, Iraq and others – opportunities. The dominance of Middle East oil and gas in the Chinese market means that the region will retain its importance in Chinese policy. In the first 11 months of 2018, imports of LNG reached 47.5 million tons, a 44 percent over the same period in 2017.Total natural gas imports, including both pipeline gas and LNG, rose 32 percent to a record of 90.4 million tons last year.[2]

China has become the world's leading importer of natural gas. As a result of economic growth and policies to reduce air pollution, China accounts for 37% of the expected global increase in natural gas consumption between 2017 and 2023, more than any other country. As domestic production cannot keep pace, China becomes the world's largest natural gas importer by 2019 and with 171 billion cubic meters (bcm) of imports by 2023, is mostly supplied by liquefied natural gas (LNG).[3]

An increasing role for natural gas – officially defined as a clean energy source – in every sector of the economy is part of China's 13th Five-Year Plan. China's demand is forecast to grow at an average of 8 percent per year, accounting for over a third of global demand increase. The share of imports in China's supply rises from 39 percent to 45 percent over the forecast period. Other emerging Asian economies will also increase their natural gas consumption for industry (including fertilizers and petrochemicals) and power generation and develop their domestic markets and infrastructure to import more LNG.[4]

China's economic growth has been partly driven by external demand, with foreign companies setting up assembling plants for re-exports and exploiting labor cost advantage. The rapid expansion of production capacity led to extraordinary rates of trade growth and foreign direct investment was an important source of capital. This trend stalled in the mid-2000s, as the improvement of living standards and the rise in labor costs encouraged a growing number of foreign companies to consider China as a market rather than just the world's factory.

Chinese demand for foreign high-tech goods has increased considerably. Concomitantly, as Chinese firms began to produce more sophisticated products, an increasing share of value added was produced domestically. However, the Belt and Road initiative, discussed below, will likely facilitate new forms of international economic integration.

Given China's need to import fuel, it has tried to develop markets for its products in the Middle East. The value of trade in goods between China and the Middle East rose sharply from 2000 to 2014 and then fell. China's imports from the region rose from about $12 billion in 2000 to $173 billion in 2014 and then fell sharply. The fall was due to the decline in oil prices and slower growth in oil demand. Exports increased from about $12 billion in 2000 to some $150 billion in 2014 and have declined by about 10% since then.

China's relations with Israel are different because they are not based on oil or gas. China imports hi-tech goods and services and sells consumer goods and construction projects. Chinese workers are employed on these projects and elsewhere in the Israeli economy.

Chinese trade with the Middle East should be seen within its wider context. China has become much less reliant on foreign trade; both exports and imports have taken smaller shares of GDP in recent years and the growth of its economy has become more reliant on domestic demand. The development of a more sophisticated economy has been one of the main factors behind China's close economic relations with Israel.

The Belt and Road Initiative (BRI) is China's program to improve cross-border connectivity on a transcontinental scale. The initiative aims to strengthen infrastructure, trade, and investment links between China and 64 other countries that account collectively for 30 percent of global GDP and 62 percent of the population. BRI consists of the Silk Road Economic Belt and the New Maritime Silk Road. The Silk Road Economic Belt, or the "Belt," and the Maritime Silk Road, or the "Road," were announced in 2013. The "Belt" will link China to Central and South Asia and onward to Europe, while the "Road" will link China to the nations of Southeast Asia, the Gulf countries, North Africa, and on to Europe. Six additional economic corridors have been identified to link other countries to the Belt and Road.[5]

One of the main objectives of the BRI is to tackle China's deep regional disparities as the country's economy modernizes. China hopes its transnational infrastructure building program will spur growth in the country's underdeveloped hinterland and rustbelt. The government also wants to use BRI as a platform to address the country's chronic excess capacity in certain industries. BRI is more about migrating surplus factories than dumping excess products. One of the most important aspects of BRI is Beijing's desire to use this initiative to export China's technological and engineering standards. Chinese policymakers see it as crucial to upgrading the country's industry. Its aim is to create a regional production chain, within which China would be a center of advanced manufacturing and innovation and be the standard setter.[6]

The Middle East is part of the BRI and in 2016 China became the largest investor in the Arab region with investments worth nearly $30 billion. It surpassed the US and the UAE and now holds 32 per cent of the direct foreign investment in the region, according to figures published by the Arab Investment and Export Credit Guarantee Corp. The Middle East attracted over $92 billion worth of foreign investment according to the Investment Climate Report 2017. Nearly a third of foreign investment came from China followed by the UAE, which accounted for 16.4 percent ($15.1 billion) and the US with $6.9 billion.[7]

China is and will remain reliant on the Middle East for much of its oil import needs and to a lesser extent for gas. It will continue to see the region as a market for its products, both consumer and capital goods. As US oil production increased, from 6.9 million barrels a day (mb/d) in 2008 to 15.5 mb/d in 2018, it has less need for Middle East supplies.

Despite this, there is a strategic paradox: Chinese oil supplies and other transactions have been protected by the US forces in the Gulf. Washington currently appears much more comfortable with a long-term US military presence in the Gulf than it is about that in Syria and Iraq. The presence of naval forces is not necessarily benign. China maintains a military base in Djibouti, at Bab-el-Mandeb, the entrance to the Red Sea, which leads to the Suez Canal, one of the three principal choke points of global naval transit. Djibouti is also home to an American Naval Expeditionary Base. Chinese and

American forces have even engaged in laser skirmishes there, when China deployed high energy lasers to blind U.S. pilots.[8]

Rivalry with the US is a primary consideration for China as its relations with the Middle East evolve. China seems to have largely kept in line with US sanctions on Iran even though it has interests in buying Iranian oil and selling its products to Iran. Those interests were weighed against its relations with the US. In some respects, Chinese and US policies seem to reflect their mutual reliance. In January 2019, China held $1,127 trillion of US Treasury securities, by far the largest share held by any foreign power.[9] In 2018 the US sold goods worth $120 billion to China and bought $540 billion from it. The US trade deficit with China has increased in recent years and this is one of the factors behind the imposition of tariffs on Chinese goods.[10] In 2017, US investments in China totaled about $250 billion while Chinese investments in the US came to $150 billion.[11] In recent years, political strains have resulted in a slowdown in mutual investment.

---

[1] Daniel Workman, "Top 15 Crude Oil Suppliers to China," *World's Top Exports*, March 5, 2019.
[2] Michael Lelyweld, "China Pushes LNG Imports to the Limit," *Radio Free Asia*, January 14, 2019.
[3] *International Energy Agency*, "Gas 2018: analysis and forecasts to 2023," June 2018.
[4] Ibid.
[5] *World Bank Group,* "China: Systematic Country Diagnostic," 2017, Report No. 113092-CN, 136 pp.
[6] Peter Cai, "Understanding China's Belt and Road Initiative," *Lowy Institute for International Policy*, March 2017.
[7] *Middle East Monitor*, "China is largest foreign investor in the Middle East," July 24 2017.
[8] Ariel Cohen, "Will China replace the U.S. as the Middle East hegemon?" *Forbes*, Febraury 14, 2019; Paul Sone, "US accuses China of directing blinding lasers at military aircraft in Djibuti," *Washington Post*, May 4, 2018.

[9] *US Department of Treasury*, "Data Report," March 15, 2019.
[10] *US Census Bureau*, "Trade in Goods with China," 2019.
[11] Thilo Hanemann, Daniel H. Rosen and Cassie Gao, "Two-Way Street: 2018 Update US-China Direct Investment Trends," (Jointly published) *Rhodium Group and National Committee on US-China Relations*, April 2018.