Chapter 2

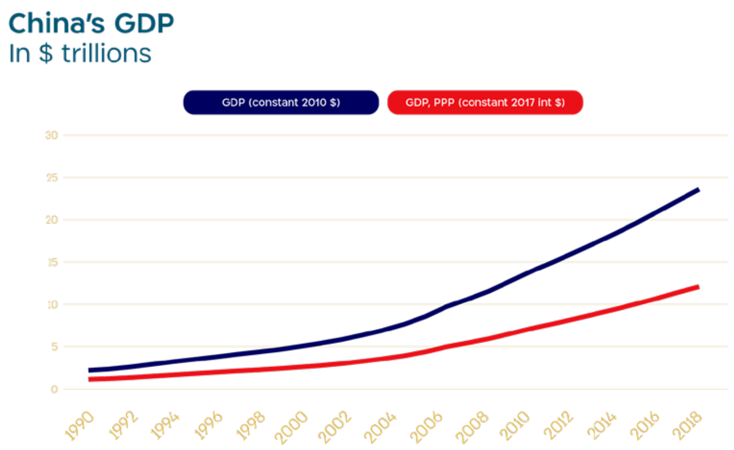
Bilateral Commerce in Regional Perspective

Economic relations with Iran are among China's most significant in the West Asia region. Iran is an energy supergiant in proven oil and gas reserves, a sizable consumer market, and a key east-west land bridge along China's Belt and Road Initiative (BRI). At the same time, China has become Iran's largest trade partner, energy client and source of investments and foreign construction contracts. And yet, not only is Iran far more reliant on China than vice versa, it is also more reliant on China than other regional states are. Moreover, Beijing has developed higher trade and investment ties with some of Iran's regional rivals and neighbors. This chapter examines the data for Iran-China trade and investment ties and contrasts them against China's other regional economic partnerships.

Between 1978 and 1979, when Ayatollah Khomeini's revolution toppled the Pahlavi monarchy, mainland China's merchandise trade with Iran as reported to the IMF dropped from $119 million to a mere $68 million. But bilateral trade recovered after the Iran-Iraq War, surpassing $1 billion in 1997 and then $10 billion in 2005. The 1990s was a time when China's economy also began growing significantly (graph 1).

China-Iran Trade

Graph 1



From the World Bank, n.d. (https://data.worldbank.org/indicator/NY.GDP.MKTP.KD?locations=CN)

Graph 2

From IMF DOTS (https://data.imf.org/regular.aspx?key=61013712)

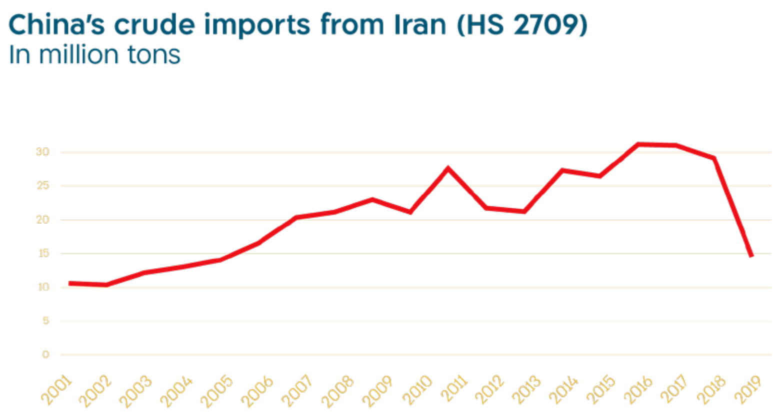
Between 2005 and 2007, at the height of the neoconservative president Mahmoud Ahmadinejad's first term, trade doubled to $20.6 billion (graph

2). This dovetailed with Tehran's "look East" strategy at a time of rising tensions with the US and the West over Iran's nuclear program. In 2010, trade reached $29.3 billion and peaked at a record $51.8 billion in 2014 during the period of international sanctions on Iran.

Although China backed these sanctions, including to significant effect from 2010, it also exploited Iran's diplomatic and trade isolation to increase its own commerce with the country. Moreover, while its economy slowed down following the 2007-2008 subprime financial crisis, in 2009 China still overtook Germany as the world's leading goods exporter, and in 2013 it surpassed the US as the world's largest trading state. When disaggregated, China-Iran export and import data still peaked during the 2010-2015 international sanctions period. China's exports to Iran surpassed $10 billion in 2010 and crested at $24.3 billion in 2014. Imports from Iran similarly peaked at $30.2 billion in 2011. However, as the US' maximum pressure on Iran intensified between 2018-2019, China's total trade with the Islamic Republic declined from $36 billion to $23 billion.

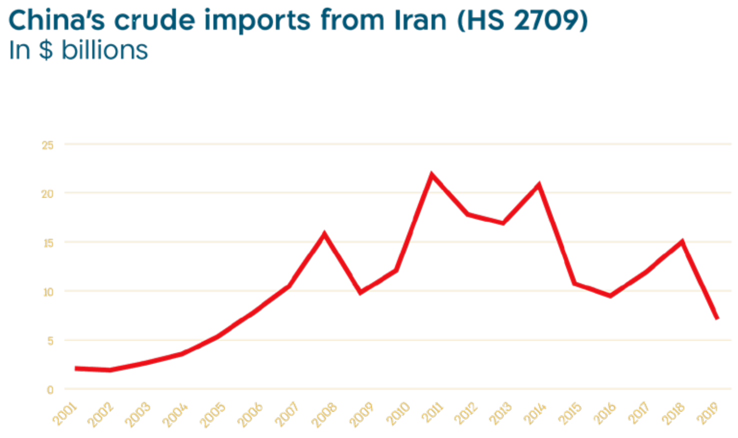
Merchandise Trade

Graph 3



From International Trade Centre (ITC), n.d. (https://bit.ly/3ue2gpD)

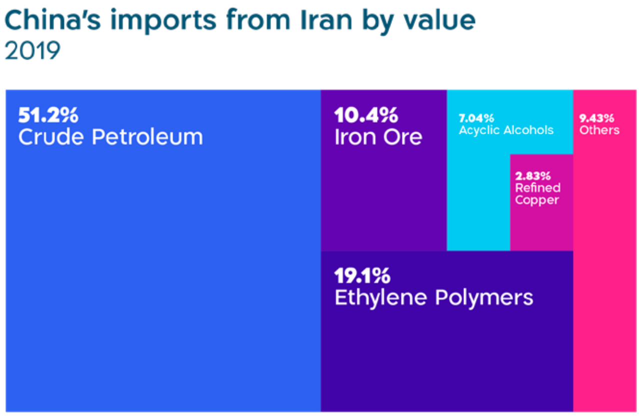
Graph 4



From ITC, n.d. (https://www.trademap.org/Bilateral_TS.aspx)

The bulk of Iran's exports to China has traditionally comprised crude oil, condensate and other energy products. According to International Trade Centre (ITC) data, China's crude imports by tonnage from Iran trebled from 10.8 million in 2001 to 31.3 million in 2016 (graph 3). By value, they rose elevenfold from $2 billion in 2001 (10.8 million tons) to $21.8 billion in 2011 (27.7 million tons), amid international sanctions (graph 4). In 2013, China surpassed the US as the largest net importer of total petroleum and other liquid fuels. But in 2019, under reinstated US sanctions, China's Iran crude imports dropped to $7 billion, and remained depressed through the rest of the Trump presidency, at least according to official statistics. As an indicator of oil dominance, the peaks and troughs in both China's crude imports from Iran (graph 4) and overall bilateral trade (graph 2) in value terms largely correlate.

Treemap 1

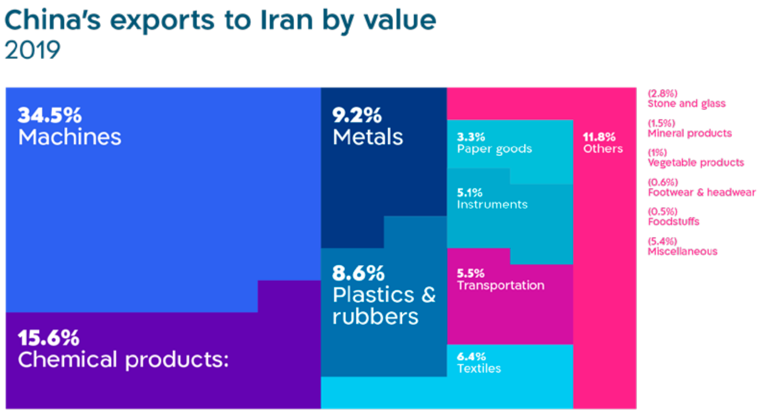


From the Observatory of Economic Complexity (OEC), n.d. (https://oec.world/en/visualize/tree_map/subnational_chn/import/chn/irn/show/2019/)

Even in 2019, crude petroleum still made up over 51 percent of Iranian exports by value, according to UN Comtrade data as reported by the Observatory of Economic Complexity (OEC, treemap 1). Combined with other mineral exports like iron ore, the figure rises to 65 percent. The next largest group of Iranian exports at 20 percent comprised polymers, followed by chemical products, metals like refined copper and semi-finished iron, and then vegetable products like nuts, fruits and spices. In 2011, when Iranian exports to China peaked, crude alone comprised nearly 75 percent (84 percent if all mineral products are included). In 2020, with Iranian crude exports reduced by sanctions, the share of other export categories increased.

On the other hand, Chinese exports to Iran are highly varied. Iran is a sizable consumer market just as it is a major source of hydrocarbons. China's exports comprise a sprawling catalogue of raw, semi-finished and finished goods including vehicles and vehicle parts, electronics, precision instruments, metal products, everyday consumer goods, tea and various spices, even textiles and carpets, Iran's signature export. Given Iran's limited refining capacity and aging infrastructure, it also buys refined petroleum from China.

Treemap 2



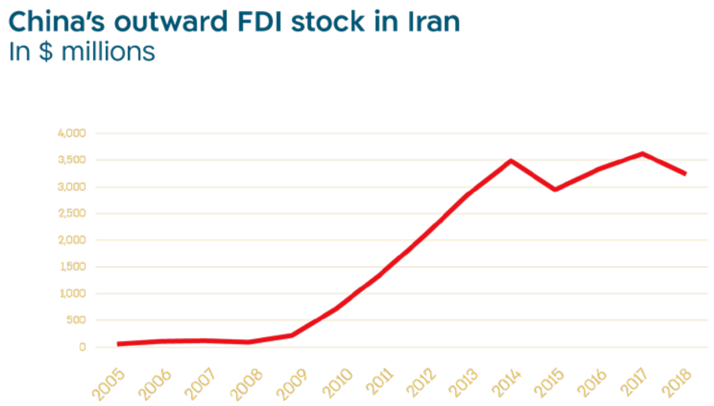
From OEC (https://oec.world/en/visualize/tree_map/subnational_chn/export/chn/irn/show/2019/)

In 2019 for instance, one third of the value of China's exports comprised electronics, electrical equipment, and industrial machinery (OEC, treemap 2). Chemical products represented the next largest group at 15 percent. The composition was similar in 2014, when China's exports to Iran peaked. Despite growing international sanctions during the 2010-2015 period, Beijing continued buying Iranian crude. Yet, Chinese goods, largely low-quality and also deliberately imported by Iranian merchants rather than solely pushed by their Chinese counterparts, flooded Iran's bazaars, prompting Tehran to ban some items already being produced at home.

Where Tehran's conservative hardliners favored close trade and strategic ties with China as a way of affirming Iran's own independence and influence, the reformists and moderate conservatives instead saw the historical peril of inordinate reliance on a foreign power. In the bazaars, many merchants and ordinary Iranians too saw China's growing commercial presence with a mix of resentment, frustration, and unease. On the other hand, where the West had failed them, China stepped into the breach, offering a critical lifeline. The moderate conservative government of President Rouhani has hence had to close ranks with its domestic rivals in moving closer towards China.

Chinese Investments and Construction Contracts

Graph 5



From *Statistical Bulletin of China's Outward Foreign Direct Investment*, 2011, 2018, Chinese Ministry of Commerce

Graph 6

From China Global Investment Tracker, n.d. (https://www.aei.org/china-global-investment-tracker/)

China's FDI stock in Iran grew from $56 million in 2005 to $3.5 billion in 2014, through the period of UN sanctions, and again peaked at $3.6 billion in 2017 after the nuclear agreement known officially as the Joint Comprehensive Plan of Action (JCPOA) came into force (graph 5). According to World Bank data, the single largest FDI net inflow into Iran of any year was also in 2017, at over $5 billion in current dollars. China's capital controls – put in place to regulate its forex reserves, balance of payments, and currency exchange rate – limit how much money beyond non-financial investments Chinese firms can move abroad, especially since late 2016. Beijing's regulators however view BRI-related investments in a strategic rather than commercial light. Furthermore, many of these infrastructure projects are not only spearheaded by politically-connected state-owned enterprises but are also financed by loans from Chinese policy banks (i.e., the China Development Bank and the Export-Import Bank of China) rather than FDI.

According to the American Enterprise Institute and Heritage Foundation's China Global Investment Tracker, between 2005 and 2020 (until October 2020), Chinese investments combined with construction contracts in Iran totaled $26.56 billion, peaking at $3.39 billion in 2017 (graph 6). During the entire period, Iran's energy sector received 40 percent ($10.74 billion), the transport sector 26 percent ($6.92 billion), and metals just under 19 percent ($4.96 billion). While these figures varied during the 2010-2015 sanctions period, they have fallen dramatically since 2017, when Trump came into office.

Within the energy sector, in July 2006 Sinopec (China Petrochemical) for instance agreed to a $2.84 billion construction contract to expand Arak refinery's capacity. In December 2007, Sinopec and the National Iranian Oil Company (NIOC) signed a $2 billion buy-back agreement for development of the Yadavaran field. Then in January 2009, China National Petroleum Corporation (CNPC) and NIOC signed a $1.76 billion agreement to develop the north Azadegan oil field. That same year, CNPC also inked a $4.7 billion deal, replacing France's Total, to develop South Pars Gas Field's Phase 11.

But there were also problems. In July 2012, CNPC was forced to pull out under sanctions pressure, and in April 2014, citing repeated delays, Tehran cancelled a $2.5 billion contract for South Azadegan reportedly agreed in 2009. Then in November 2016, after the start of the JCPOA's implementation, CNPC again signed the South Pars Gas Field Phase 11 agreement, taking up a 30-percent minority stake alongside France's Total and Iran's PetroPars, only to find itself by October 2019 again forced to withdraw, this time under US sanctions pressure.

Transport followed the energy sector in importance. After previous involvement in building the Tehran metro, Norinco (China North Industries Corporation) signed several construction contracts between 2006 and 2012, the largest for $1.25 billion with Tehran Urban and Suburban Railway Co. to further expand Tehran metro's Line 6. In 2015, China Railway Group Limited (CREC, an acronym left over from its predecessor China Railway Engineering Corporation) finalized a contract for over $2 billion to construct the Tehran-Qom-Esfahan high-speed rail, partnering with the Revolutionary Guards' (IRGC) economic and engineering conglomerate, Khatam ol-Anbia.

That same year, China's National Machinery Import and Export Corporation (CMC) also agreed to finance the electrification of the Tehran-Mashhad railway line, although the Chinese concerns then reportedly ditched both financing and construction of the project in 2020 (Mehr News, 2021). In January 2016, Norinco inked another $330 million agreement to construct the Golbahar-Mashhad Electrified Railway. Then in January 2018, China Railway Construction Corp (CRCC) signed a $540 million Kermanshah-Khosravi railway construction contract, and that March, Sinomach finalized a $845 million contract to build the Tehran-Hamedan-Sanandaj railway line.

Among the abovementioned Chinese firms, some such as Norinco and CRCC, and others not mentioned here but including 5G telecommunications giant Huawei and CRRC, which has supplied metro cars and other rolling stock for Iranian rail systems, figure among the 31 companies the US Department of Defense has banned over links with China's military establishment (Sanders, 2020).

Payment Mechanisms

Because of sanctions, barter and the use of local soft currencies have come to play an important part. Such restrictive bilateral arrangements were what allowed the dumping of low-quality Chinese goods in Iran, even while China leveraged sanctions to secure Iranian oil discounts. For private-sector traders, the network of informal money transfer agents offers another suboptimal workaround.

Additionally, during the UN sanctions period, the Xinjiang-based Bank of Kunlun, a CNPC-owned subsidiary originally established in 2006, became the conduit for non-barter transactions and especially for oil, reducing the sanctions exposure of other Chinese financial institutions. The US Treasury sanctioned the bank in 2012. After the Trump administration reinstated Iran sanctions in 2018, the Bank of Kunlun suspended Euro-denominated transactions with Iran, and then limited its Iran dealings to renminbi-denominated humanitarian trade from after 2019, at about the time when US sanctions waivers for China and seven other Iran oil clients expired. In summer 2020, the Bank of Kunlun again reportedly refused further dealings with Tehran over the Financial Action Task Force's (FATF) blacklisting of Iran. However, on November 15, 2020, Deputy Foreign Minister for Economic Diplomacy Gholam-Reza Ansari confirmed Iran was still conducting trade with China in renminbi (Radio Farda, 2020).

China continued to import Iranian crude but justified this as payment for earlier investments in the Yadavaran and Azadegan fields. As of October 2020, China still held some $20 billion in Iranian foreign exchange earnings, more than that owed Iran by India, South Korea, Iraq, and Japan combined. Iran's difficulty in repatriating hard currency feeds into the rial's instability, and the IMF in its October 2020 update estimated that Iran can only readily access a fraction – about $8.8 billion – of its total foreign currency reserves. Still, given that Iran's long-standing crude-based trade surplus has transformed into deficit in 2020, these funds would likely instead service balance of payments requirements by financing Tehran's growing imports from China.

For their part, Chinese capital investments in Iran typically do not involve forex transfers to Iranian counterparts. Instead, they usually entail green-field investments with Chinese concerns directly financing property, equipment, and manpower requirements, perhaps in part also with Iranian funds held in Chinese accounts.

At present, both governments are mulling ways of improving bilateral transactions. In its unfinalized draft version leaked in July 2020, the 25-year cooperation agreement for instance referred to the creation of a bilateral financial settlement mechanism, a joint commercial company to facilitate goods trade, a joint Iran-China bank with branches in both countries, and the opening of Iranian bank branches or representations in Special Economic Zones in China (Foreign Ministry of the Islamic Republic of Iran, 2020). Still, unless Iran ratifies the two remaining FATF conventions on terrorism financing and money-laundering, Chinese banks will continue facing challenges transacting with their Iranian counterparts.

Chinese Commerce in Regional Perspective

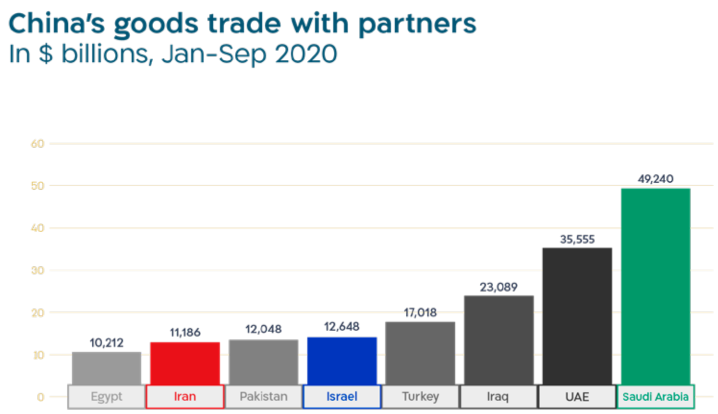
Graph 7

From IMF DOTS (https://data.imf.org/regular.aspx?key=61013712)

China's broader commerce with regional partners paints a more varied picture. Beijing's trade with Saudi Arabia and the UAE stand out in particular. In 2019, China-Saudi Arabia trade crested at $78.2 billion, with Riyadh's exports to China reaching a record $54.9 billion in 2012, with similar figures in 2019. Likewise, in 2014, the year that China-Iran trade marked its highest point at $51.8 billion, Beijing's own trade with the UAE peaked slightly higher, at $54.6 billion (some of it plausibly masking reexports between Iran and China), with China's exports to the UAE that year also cresting at $39 billion. In 2019, China-UAE trade stood at $49 billion, over twofold that of China-Iran trade (graph 7).

For perspective, Iran, with a population of 83 million and a sanctions-constrained nominal GDP of $584 billion in 2019, ought to be viewed in comparison with its leading regional economic rivals. For instance, while the 2019 GDP of Saudi Arabia, a country of 34 million, amounted to $793 billion, the economy of the UAE with a population of only 9.8 million – 12 percent of Iran's – was, at $421 billion, 72 percent that of Iran's economy (nominal GDP figures are from IMF, 2020).

Graph 8

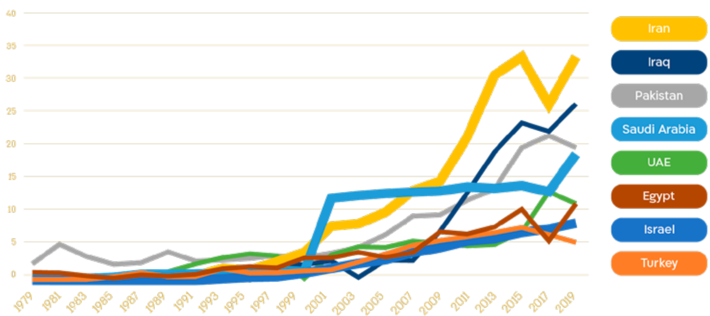


From IMF DOTS (https://data.imf.org/regular.aspx?key=61013712)

In the first nine months of 2020, as the COVID-19 pandemic took hold worldwide, China's total reported trade with Iran amounted to only $11.2 billion, compared to $49.2 billion with Saudi Arabia, $35.5 billion with the UAE, and even $12.6 billion with Israel (graph 8). Under the pandemic's levelling effect, China still apparently favors other partners.

Graph 9

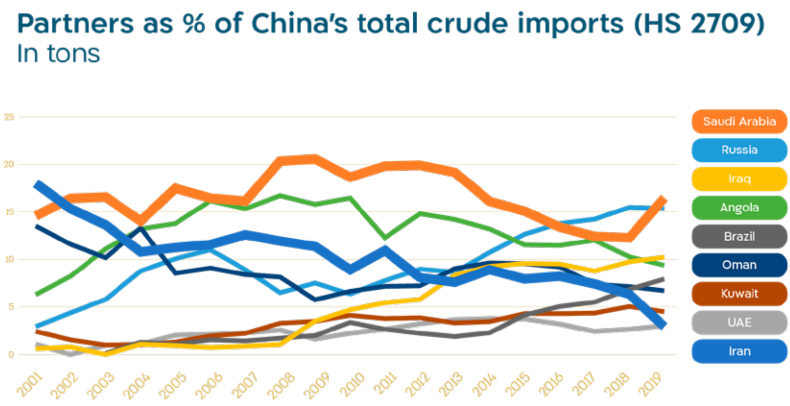
China as % of partners' total goods trade



Note: The calculations are from IMF DOTS (https://data.imf.org/regular.aspx?key=61013712)

Not only is China's bilateral trade with Saudi Arabia and the UAE more important, these two partners are also less dependent on China compared to Iran. Iran's dependence on China has steadily grown over the years, and since 2007, Iran has been the most dependent of these regional partners, with China making up a record 36 percent of Iran's merchandise trade in 2014 (graph 9). From 2015, with the signing of the JCPOA, trade dependence temporarily dipped, a reflection of Iran's increased access to other markets. But by 2019, a year after Trump withdrew from the JCPOA, a full 33 percent of Iran's total goods trade was again with China, higher than any other regional state and 13 percentage points more than even Pakistan, with which China maintains the closest strategic and investment relationship among these regional partners. On the other hand, Iran at its peak in 2011 represented a mere 1.2 percent of China's total world trade.

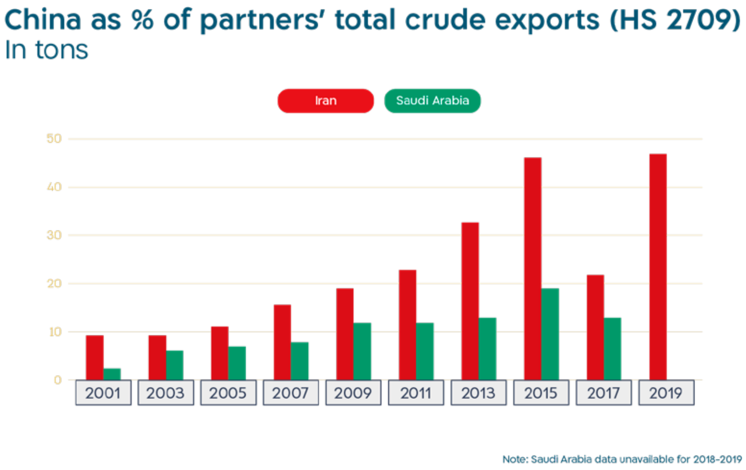
Graph 10



Note: The calculations are from ITC, n.d. (https://www.trademap.org/Bilateral_TS.aspx)

In terms of oil exports by tonnage, according to calculations based on ITC data for 2001-2019 (graph 10), Iran at its peak in 2001 supplied 18 percent of China's total crude imports, compared to Saudi Arabia's 15 percent that year, at a time when Beijing's thirst for foreign energy was rising. But Iran's proportion has largely gone downwards since, with Tehran supplying only 3 percent in 2019. Since 2001, Saudi Arabia has consistently eclipsed Iran. Between 2008 and 2013, Saudi Arabia supplied one fifth of China's total crude imports. In recent years, Saudi Arabia has remained China's top supplier, losing that place to Russia only briefly in 2016-2018. In 2019, Riyadh supplied over 16 percent of China's total crude imports, nearly six times more than Iran.

Graph 11



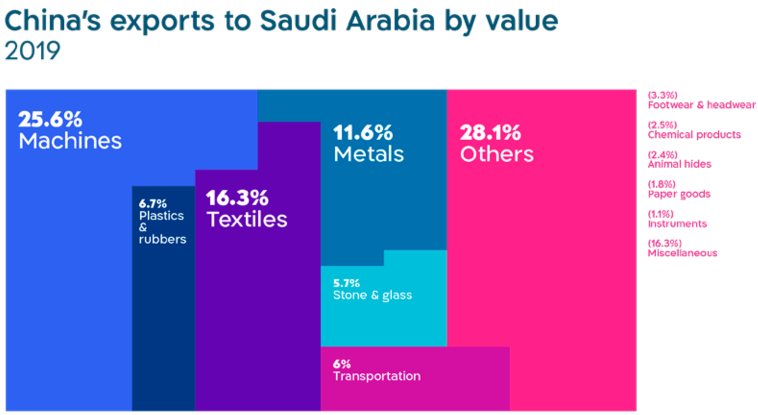
From ITC, n.d. (https://www.trademap.org/Bilateral_TS.aspx)

Likewise, while Riyadh supplies far more crude to China in absolute and relative terms than does Tehran, Iran's dependence on China as an oil client far eclipses that of Saudi Arabia. China's patronage has consistently represented a larger proportion of Iran's crude exports by tonnage, reaching 49 percent in 2014-2015, and nearly 50 percent in 2019 (graph 11). By value, the figure peaks even higher at 56 percent in 2015. Throughout 2020, firms such as Kpler and Refinitiv Eikon which track commodity markets have offered differing assessments on the volume of crude oil China has been buying from Iran. Yet they agree that China remains far and away Iran's most important client (Sharafedin & Lawler, 2020; Khatinoglu, 2020). Around the time Joe Biden assumed the US presidency, China's crude oil imports from Iran reportedly grew again, unofficially through third countries including Oman, the UAE, and Malaysia, although these imports have also yet to recover to their pre-sanctions levels (Verma & Zhang, 2021).

Broadly, the make-up of Saudi exports to China is comparable to that of Iran. In 2018, 70 percent of Saudi exports to China comprised crude, followed by polymers and then chemical products. In the UAE's case, crude in 2018 comprised 34 percent (mineral products together made up 62 percent). Before polymers and chemical products, however, the UAE's next largest export was vehicles. On the other hand, in 2018, machinery and electronics made up Israel's top export category (55 percent) to China, especially integrated circuits, followed by precision instruments and then chemical products.

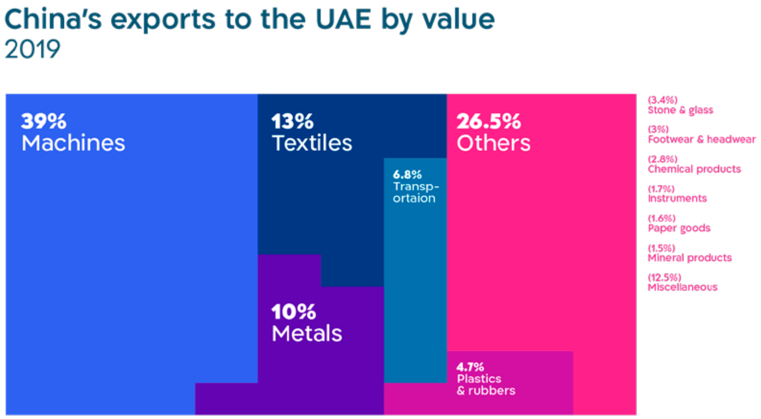
Like in Iran's case, China also exports a highly variegated catalogue of industrial and consumer goods to its other regional partners. In 2018, the largest groups of Chinese exports to Saudi Arabia, the UAE, and Israel for instance comprised machinery and equipment, followed by textiles and metals (OEC, treemaps 3-5).

Treemap 3



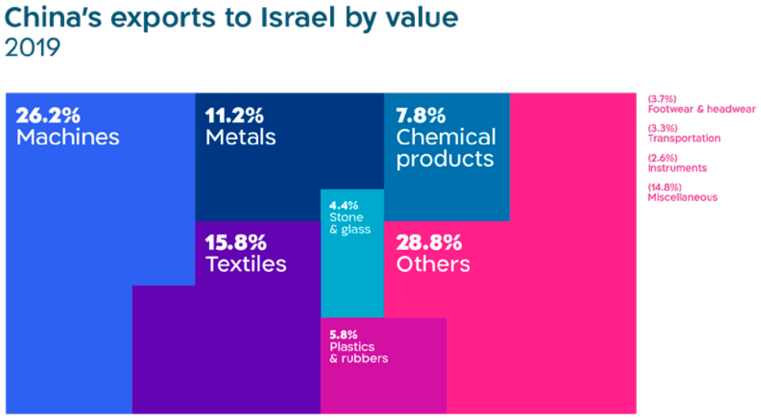
From OEC (https://oec.world/en/visualize/tree_map/subnational_chn/export/chn/sau/show/2019/)

Treemap 4



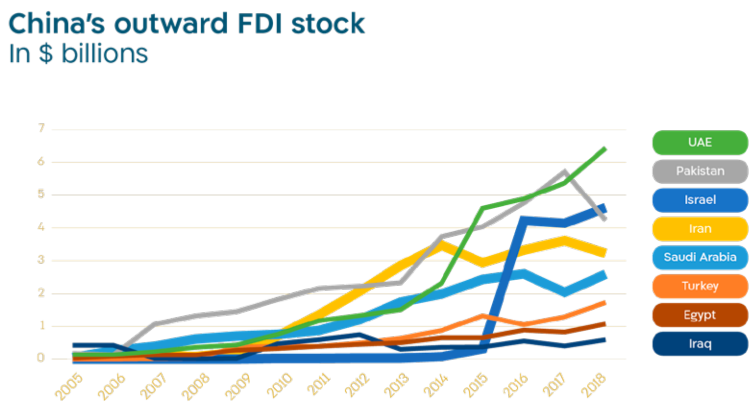
From OEC (https://oec.world/en/visualize/tree_map/subnational_chn/export/chn/are/show/2019/)

Treemap 5



From OEC (https://oec.world/en/visualize/tree_map/subnational_chn/export/chn/isr/show/2019/)

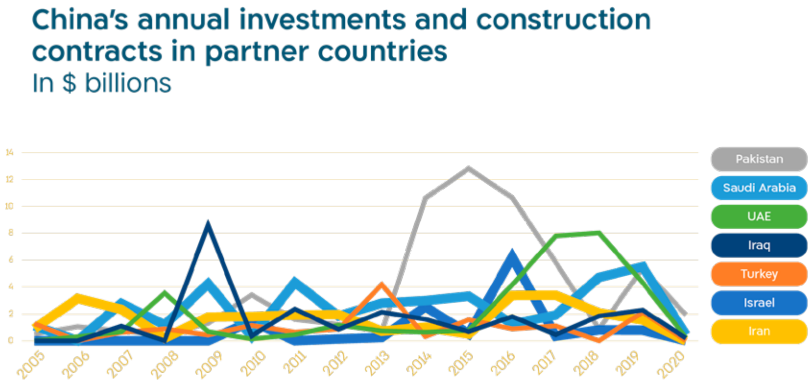
Graph 12



From *Statistical Bulletin of China's Outward Foreign Direct Investment*, 2011, 2018, Chinese Ministry of Commerce

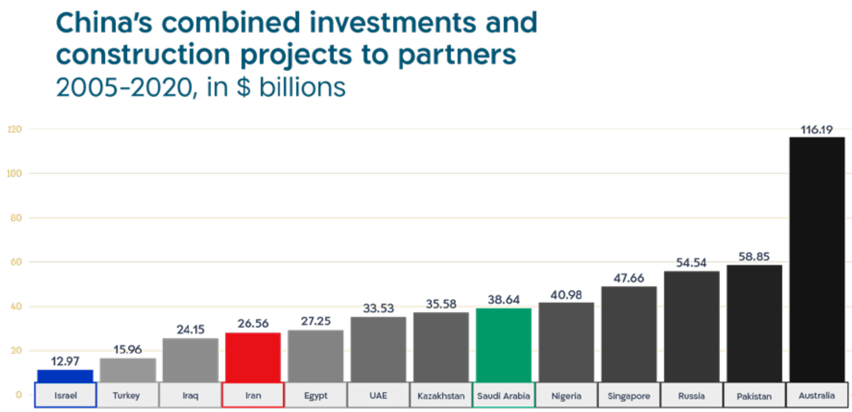
As recipients of China's FDI stock, the UAE and Pakistan have been ahead of Iran in recent years (graph 12). At its peak in 2017, Chinese FDI stock in Iran totaled $3.6 billion. At their respective peaks, Pakistan, the UAE, and Saudi Arabia's figures reached $5.7 billion (2017), $6.4 billion (2018), and $2.6 billion (2016). While China's FDI stock in Israel long remained relatively negligible, in 2016 it rose thirteenfold, notably in the technology and life sciences sectors, before declining after 2018, according to INSS data (Ella, 2021).

Graph 13



From China Global Investment Tracker, n.d. (https://www.aei.org/china-global-investment-tracker/)

Graph 14



From China Global Investment Tracker, n.d. (https://www.aei.org/china-global-investment-tracker/)

According to the China Global Investment Tracker, between 2005 and 2020, China channeled more investments and construction contracts combined into Iran, at $26.56 billion, than into regional countries like Iraq ($24 billion), Algeria ($23.9 billion), Turkey ($15.96 billion), Israel ($13 billion), Kuwait ($10.75 billion), Qatar ($7.72 billion), Oman ($5.8 billion), and Bahrain ($1.42 billion). However, it also allocated $38.64 billion in Saudi Arabia, $33.53 billion in the UAE, $27.2 billion in Egypt, and above all $58.85 billion in Pakistan (graphs 13-14).

In Saudi Arabia, China's portfolio is comparably more diversified than in Iran, with energy comprising 37 percent ($14.34 billion), transport 15 percent ($5.88 billion), and both utilities and real estate at 14 percent ($5.58 billion and $5.57 billion). In the UAE, energy comprises 51 percent ($17.24 billion), real estate 24 percent ($8.13 billion), and transport 12 percent ($4.07 billion). In Pakistan, the bulk of Chinese investments and construction contracts have gone into the energy sector at 70 percent ($41.39 billion), followed by transport at 21 percent ($12.29 billion). In value terms, Pakistan remains a cut above the others, including Iran, since the China-Pakistan Economic Corridor (CPEC) so far remains Beijing's single largest investment focus along its Belt and Road Initiative.

Conclusions

The foregoing data position Iran among China's more important trade and investment partners in the region, but certainly not its most important, let alone among China's top partners globally. Regionally, these most prominently include Saudi Arabia and the UAE. Elsewhere, they include many of the major Western governments starting with the US itself. On the other hand, Iran only contributes to a negligible slice of China's overall trade, while China comprises a significant chunk of Iranian trade. Despite the size of Iran's energy reserves, and even if they are cheaper because of sanctions, hydrocarbons are ultimately fungible and available from elsewhere. With some exceptions, like ferrous metal products, handwoven carpets, and pistachios, the quality of Chinese imports from Iran is not largely distinguished from parallel imports from countries like Saudi Arabia. Conversely, though lower in total value, Israeli exports come higher up on the value chain.

China-Iran trade and investments have both benefited from and suffered under UN and US sanctions. If trade and FDI stock reached new levels between 2010 and 2015, energy-sector contracts remained far shakier, as Iran's experience with the South Pars Gas Field and South Azadegan projects shows.

Relative to hydrocarbon projects, China's investments and construction contracts in Iranian infrastructure including railways and urban subways appear to be on slightly firmer ground. These include the Tehran-Qom-Esfahan railway, Iran's only high-speed line, construction of which apparently continues despite sanctions and COVID-19. But still, Chinese infrastructure projects have gone smoother in other regional countries.

Similarly, although Iran's energy reserves, economic dynamism, and geolocation might hint otherwise, it is partners like Saudi Arabia, the UAE and Pakistan which China has so far privileged. Meanwhile, Iran more than others has had to increasingly rely on China for trade and investments notably during sanctions periods, which gives Beijing significant leverage. If Iran-US relations again improve and sanctions are lifted, Beijing would face less obstacles doing business with Iran. But the paradox is that Tehran would then also have more leeway and – for the moderate conservative and reformist factions – incentive to rediversify trade relations and reduce its reliance on China.

At present, with COVID-19's disruptive effect on external commerce and supply chains compounding the trade war with the US, China will also likely tone down its heavy focus on exports, investment outflows and loans, especially as partner economies struggle to recover. In May 2020, Xi Jinping announced a "dual circulation" strategy in line with which China would rebalance its hitherto externally-oriented growth model with greater domestic demand. The 14th Five Year Plan (2021-2025) preliminarily outlined in late October and finally released in March 2021 adds further detail, emphasizing high-quality (as opposed to high-speed) domestic growth, domestic markets, self-innovation and self-sufficiency in technology, especially along the Yangtze River Economic Belt (Yao, 2020; Wong, 2020).

This in turn carries implications for China's overseas trade and investment partnerships moving forward, particularly in regard of the now official 25-year China-Iran cooperation agreement. Whatever the finalized text – and neither side has so far published the full details or indicated if they differ from those of the July 2020 leaked draft – the agreement and specifically the magnitude of proposed Chinese investments and, importantly, their long-term implementation should hence be viewed in this light.