

Growing but Limited: Iranian Economic Relations with China

Tomer Fadlon and Raz Zimmt | No. 1890 | August 27, 2024

The tightening of relations between China and Iran is considered one of the main factors preventing the collapse of Iran's economy, which has been subject to sanctions since the United States withdrew from the nuclear agreement in 2018. This improvement in relations began at the height of the COVID-19 crisis when the two countries signed a long-term cooperation agreement aimed at strengthening their economic ties in the following years. However, in practice, this partnership has been very limited and fundamentally asymmetric. Despite the sale of Iranian oil to China and Chinese exports to Iran, which serve as substitutes for many Western products, China does not provide a solution for most of Iran's economic problems, including the need for infrastructure investments. The sanctions leave Iran with no real alternative to China, and China is taking advantage of this situation to exert influence through trade and to purchase Iranian oil at substantial discounts.

Iran has been developing its diplomatic relations with China since 1971, when China joined the UN and was awarded a seat in the UN Security Council. Following the 1979 Islamic revolution in Iran, China gradually became an important player in the country. China viewed Tehran as a political counterweight to the United States and the Soviet Union, an economic asset with an important market, and an extremely valuable energy source. In turn, Iran regarded China as a bulwark against the hostile West, particularly in the international arena. Iran's diplomatic isolation led to closer ties with China, especially during the Iran–Iraq War, when Iran needed military, economic, and technological aid, which it obtained from China. After the war ended, as Iran sought to rebuild, the Tehran government upgraded its relations with China. In the last decade of the 20th century and the beginning of the 21st century, China supplied Iran with arms and technical expertise and built civilian and energy infrastructure in the country.

Economic Interests of Tehran and Beijing

In the 21st century, while Western companies abandoned Iran after economic sanctions were imposed, China did not, even expanding its influence there. Until the sanctions were removed following the nuclear agreement signed by Iran and the global powers in July 2015, China had been Iran's primary and almost sole economic partner, enjoying commercial advantages that were not always in Iran's favor. After the sanctions were lifted, Iranian President Hassan Rouhani attempted to attract as much foreign investment as possible and open the Iranian market to Western players.

However, when the Trump administration withdrew from the nuclear agreement in May 2018 and reimposed economic sanctions on Iran, the Iranian government was forced to rely on China once again and seek Chinese assistance in circumventing the sanctions.

In October 2018, Iranian Supreme Leader Ali Khamenei stated that Iran should look to the East rather than the West. Furthermore, as the world's leading exporter of goods, China could provide a reasonable alternative for almost any product lacking in Iran. For example, the use of smartphones manufactured by the Chinese company Xiaomi has significantly expanded in recent years, with its phones now accounting for a third of the Iranian market. This trend has extended to other sectors, ranging from technology products to textiles. Disappointment with Europe's failure to create mechanisms that would circumvent the sanctions and facilitate business between Europe and Iran also contributed to Iran's adoption of an eastward-facing strategy. In contrast, those in Iran who opposed greater cooperation with China argued that Beijing was exploiting Iran and enhancing its profits at the expense of Iran's struggling economy. They emphasized that the relationship between the two countries was asymmetric and not a partnership of equals.

In March 2021, China and Iran signed a historic 25-year cooperation agreement, centered on an economic partnership between them. This agreement marked the culmination of diplomatic efforts between the countries, which had made significant progress following the historic visit to Tehran by Chinese President Xi Jinping in January 2016. The highlight of the visit was the discussion of potential Chinese investments in Iran, amounting to billions of dollars (hundreds of billions of dollars, according to some assessments) in exchange for a supply of cheap Iranian oil to China.

At the same time, however, it appears that the agreement signed by the two countries has not yet been implemented. Although China is helping Iran keep its head above water, much of the potential of the Iranian market remains untapped, particularly in terms of investments, and China is not significantly contributing to the development of the Iranian economy. Therefore, it can be said that China is playing a double game—avoiding burning its bridges with the West, especially the United States, while allowing Iran to evade the sanctions and survive economically.

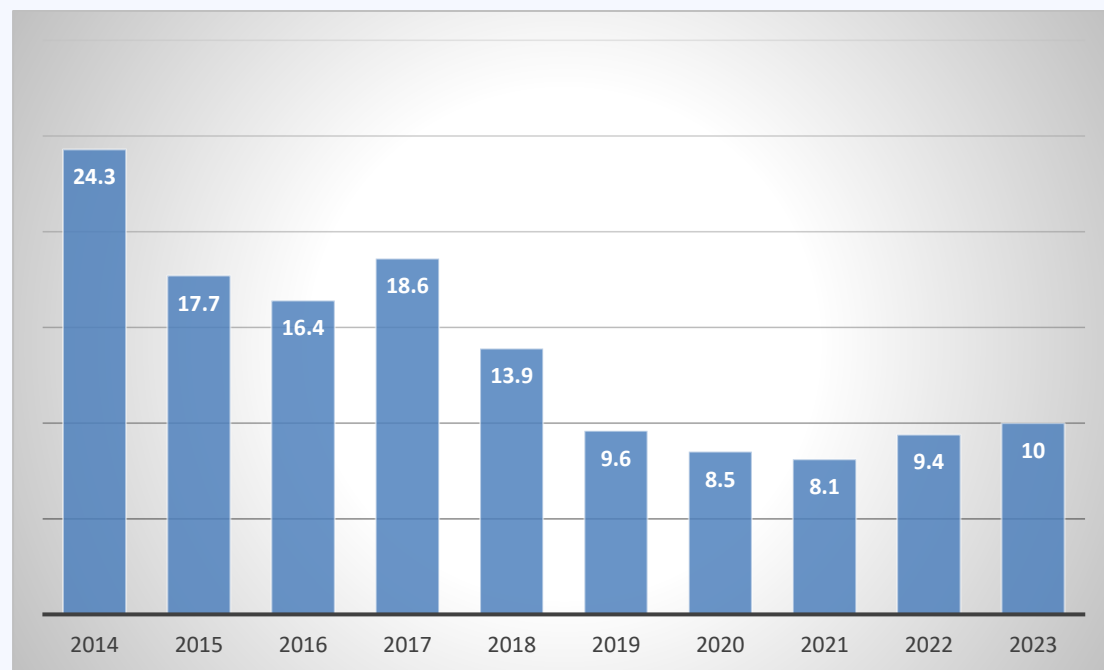
Iran's continued dependence on China, along with its role as a market for Chinese goods and an important energy source, serves Beijing's interests very well. From the Chinese perspective, the three key reasons for strengthening economic ties with Iran today are:

1. **Energy**—For many years, China has viewed the Middle East as a crucial source for meeting its energy needs. Amid sanctions, the search for cheap and accessible oil has made Iran more attractive than before. The difficulty Iran faces in exporting its oil forces it to sell at a substantial discount on the market price.
2. **A market for Chinese goods**—China maintains economic ties and trade with countries worldwide, including North Korea, Russia, and Iran, despite imposed sanctions. In the absence of significant competition, these countries provide China with a convenient market for exporting its goods. Although large companies in China are concerned about American sanctions, they have eventually found indirect ways to trade with sanctioned countries. Small Chinese companies are less sensitive to sanctions, and trade also occurs through smuggling, which has become sophisticated due to Iran's extensive experience.
3. **China's ambition to position itself as an alternative to the United States** in the evolving global order and to enhance its influence through trade and investments is also evident in the case of Iran. Iran is part of the Chinese Belt and Road Initiative. Additionally, in early 2024, Iran became a part of the economic cooperation between the BRICS countries (BRICS was founded by Brazil, Russia, India and China).

Areas of Economic Relations between China and Iran

Economic relations between Iran and China are concentrated in three main areas: international trade in goods, Iranian oil exports to China, and Chinese investments in Iran. An examination of trade between the two countries reveals an interesting picture. While Chinese exports are helping Iran find alternatives to goods that would have been supplied by Western countries if not for the sanctions, Iran's imports of Chinese goods have significantly decreased since economic sanctions against Iran were reinstated in 2018 following the US withdrawal from the nuclear agreement in May of that year. Chinese exports of goods to Iran totaled \$10 billion in 2023 (see Figure 1), the highest yearly total in 2019–2023, but still 30% less than 2018, when Chinese exports to Iran peaked at \$13.9 billion—the same year that sanctions were reimposed on Iran. This amount is much lower than China's peak exports of \$24.3 billion to Iran in 2014. This decline can be attributed both to an actual drop in Chinese exports to Iran and to Chinese exports being routed through a third country due to concerns among Chinese companies about circumventing secondary American sanctions against Iran. These concerns led to a significant decrease in Chinese exports to Iran starting in the second half of 2018.

Figure 1. Exports From China to Iran (in Billions of US Dollars)



Source: COMTRADE

Chinese exports to Iran cover a wide range of sectors, with about 70% falling into three primary categories. The first category includes vehicles, such as private cars and motorcycles, as well as spare parts for these vehicles, accounting for a quarter of total exports. The second category comprises [machinery, nuclear reactors, and boilers](#). The third category consists of electronic equipment.

Trade figures clearly demonstrate an imbalance between the two countries. Iranian imports from China constituted over 15% of Iran's \$65 billion in total imports in 2023. In contrast, Chinese exports to Iran constituted only 0.3% of China's total exports of goods, which reached \$3.38 trillion in the same year. In other words, Iran is just one of many markets for Chinese goods, whereas China is a major source for Iran's imports.

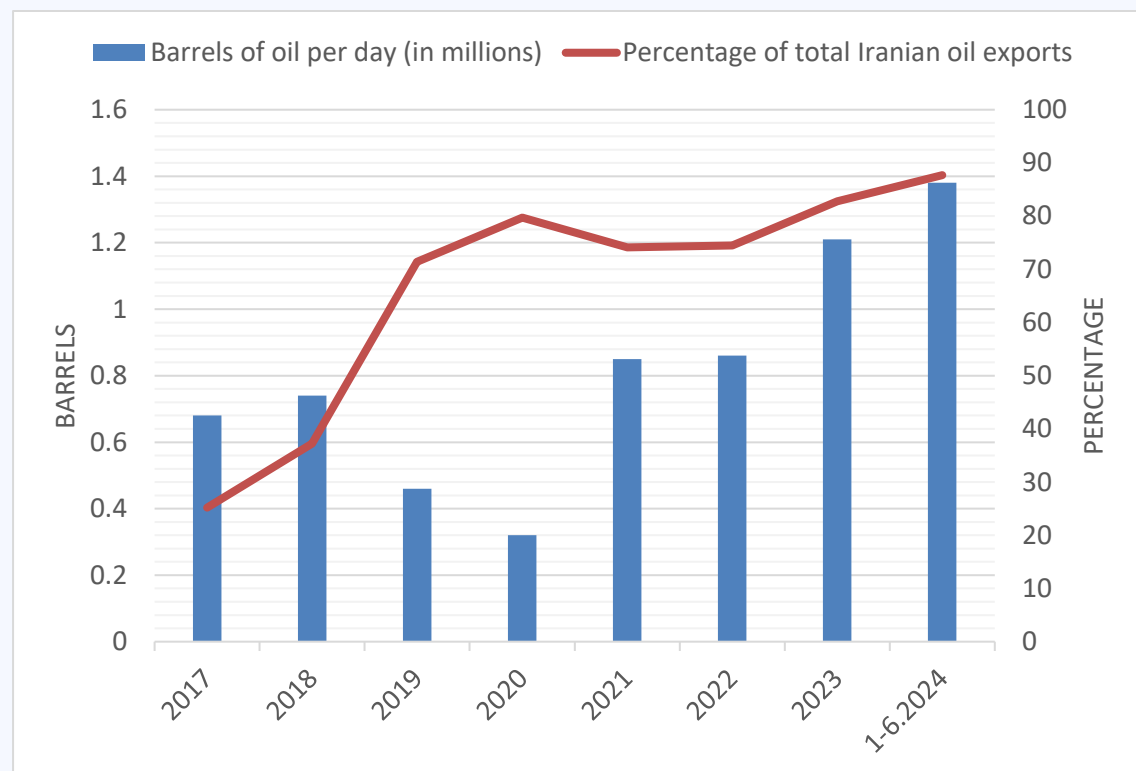
Iranian exports to China predominantly consist of oil. Data on Iranian oil exports to China clearly show an increase in both volume and the proportion of total Iranian oil exports to China (see Figure 2). Two other important trends should also be noted. First, Iranian oil exports to China significantly increased following the COVID-19 crisis, surpassing pre-pandemic levels. The volume of oil exports grew from 118 million barrels in 2020 to 441 million barrels in 2023, representing a 350% increase. This indicates that China imported an average of 1.2 million barrels of oil per day from Iran in 2023. The trend continued in the first half of 2024, with China importing a daily average of 1.38 million barrels of oil from Iran.

Second, Iran has become almost entirely dependent on China as a market for its oil. In 2017, Iran exported only a quarter of its oil to China. However, when economic sanctions against Iran were implemented in late 2018, exports of Iranian oil to China fell from 272 million barrels in 2018 to 170 million barrels in 2019. Despite this, China's share of Iranian oil exports rose from 37.2% in 2018 to 71.4% in 2019. By 2023, it exceeded 80% of total Iranian oil exports and reached 90% in 2024. Exports of Iranian oil to China increased significantly despite disagreements between the two countries over the price of the oil.

After the war in Ukraine began and sanctions were imposed on Russian oil, Iran faced competition from the lower prices at which Russia offered its oil to China. The main beneficiary of this development was China, which reportedly saved \$10 billion in 2023 on its imports of Iranian and Russian oil due to the substantial discounts. This underscores Iran's heavy dependence on China, while China has alternatives for Iranian oil, with only 10% of China's oil imports coming from Iran.

At the same time, circumventing sanctions on Iranian oil exports to China does not resolve Iran's foreign currency problem because China uses small Chinese banks to pay for Iranian oil in Chinese yuan, not dollars. Furthermore, Iran is required to use these revenues to purchase Chinese goods. Despite Iran's efforts to reduce its dependence on oil, various estimates indicate that one-third of Iran's budget comes from oil revenue. Thus, the sanctions have made oil exports even more crucial for Iran.

Figure 2. Oil Exports from Iran to China



Source: Statista, United Against Nuclear Iran

The nuclear agreement sparked hope in Iran that foreign investors would be attracted to the country. However, the reimposition of sanctions significantly impacted foreign direct investments, which totaled only \$8.1 billion from 2018 to 2022, compared to over \$5 billion in 2017 alone. Chinese investors failed to fill the gap left by Western investors; China invested only \$618 million in Iran during the years 2018–2022, accounting for 7.5% of all direct foreign investments in the country. Most of these investments were in the construction industry.

Foreign investments in Iran experienced a significant decline following the sanctions. Chinese companies were reluctant to invest in Iran due to both the sanctions and the country's economic and political instability. Furthermore, Chinese companies that had invested in Iran following the 2015 nuclear agreement withdrew their investments when the sanctions were reimposed. For example, the national Chinese oil company that had signed an agreement in 2016 to invest \$600 million in the South Pars natural gas field canceled its investment when the sanctions were reinstated. While China invests billions in Saudi Arabia, the United Arab Emirates, and other countries in the region under the Belt and Road Initiative, its investments in Iran remain minimal. For comparison, in 2022, China invested \$1.5 billion in Saudi Arabia and \$1.3 billion in the UAE.

This trend has led to internal criticism in Iran from those who argue that Beijing is exploiting Iran at the expense of its struggling economy. Critics emphasize that the relationship between the two countries is asymmetric and does not constitute an equal partnership. Moreover, Iranian businesspeople object to the fact that Chinese companies offer cheap products, which makes local products in Iran less competitive. Iranian consumers also complain about the quality of Chinese consumer goods imported into Iran.

Conclusion

China plays a crucial role in Iran's ability to circumvent the sanctions, primarily through oil exports. However, their economic partnership remains limited, especially regarding China's investments in non-oil trade and major infrastructure projects in Iran. The sanctions, Iran's refusal to adhere to the recommendations of the Financial Action Task Force (FATF)—the international task force for combating money laundering and terrorist financing—and structural issues within Iran's economy, such as poor management, corruption, and lack of transparency, all hinder economic cooperation between the two countries. As a result, Iran heavily relies on China and lacks alternatives from Western countries. The improvement in economic relations between Iran and China largely depends on a diplomatic resolution between Iran and Western countries, led by the United States. This resolution could facilitate the removal or at least the relaxation of sanctions. Conversely, stricter enforcement of US sanctions on Iranian oil exports to China is likely to significantly harm their economic relations; however, it is doubtful that the United States can compel China to adhere more strictly to these sanctions.

Editors of the series: Anat Kurtz, Eldad Shavit and Ela Greenberg