

# Belt and Road Initiative in the Gulf Region: Progress and Challenges

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China and countries in the Gulf region are at Asia's eastern and western ends respectively, linked by the ancient Silk Road across the Gobi desert. In the new century, the Belt and Road Initiative has become the main focus of strategic cooperation between the two sides. The Gulf countries are "natural cooperative partners" in the Belt and Road construction<sup>1</sup> in an important geographical area difficult to bypass. Although the political and security situation in the Gulf region is complicated and unpredictable, presenting challenges to the implementation of the Belt and Road Initiative, there remains room for a turnaround in the situation of West Asia and North Africa including the Gulf region itself. China should seize this opportunity, circumventing possible risks and enhancing pragmatic cooperation under the Belt and Road Initiative.

## Strategic Importance of the Gulf Region

The Gulf region, including the Gulf Cooperation Council countries plus Iran and Iraq, is situated in the area where the three continents of Asia, Africa and Europe and the five seas of Mediterranean, Red Sea, Arabian Sea, Caspian Sea and Black Sea converge, and is adjacent to the four maritime

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<sup>1</sup> In a meeting with a delegation from the Gulf Cooperation Council (GCC) in January 2014, Chinese President Xi Jinping described China and the GCC as good brothers, friends and partners featuring high mutual trust, substantial trade cooperation and close cultural and people-to-people exchanges. See Wu Sike, "Constructing 'One Belt and One Road' to Enhancing China and GCC Cooperation," *Arab World Studies*, No.2, 2015, pp.4-13.

strategic channels of Bosphorus, Dardanelles, Mandeb and Hormuz. The area is also at the intersection of the Silk Road Economic Belt and the 21st Century Maritime Silk Road. With its advantageous location, unique endowment of resources and huge industrialization potential, the Gulf region's strategic importance is beyond doubt.

The Gulf region holds a prominent position in the Belt and Road construction, providing a positive demonstration effect across the entire Arab world. After World War II, affected by the US-Soviet competition for hegemony and the Arab-Israeli conflict, the Levant region with Palestine at the center attracted widespread attention from the international community. Following the Gulf War, the United States' diplomatic strategy of "containing Iraq and Iran in the east and promoting peace talks in the west" brought stability to Levant and the Gulf region. In the wake of the Iraqi War, especially with the emergence of the Iranian nuclear issue, regional structure presented a feature of "rising east and declining west." GCC countries have generally remained stable in the turmoil that spread West Asia and North Africa, and made an attempt to incorporate Jordan and Morocco into the organization in May 2011. Following two successive revolutions in Egypt and the signing of the Iranian nuclear agreement in 2015, the Saudi Arabia-led GCC began to dominate the affairs of the Arab League. As a result, the influence and strategic importance of the Gulf region increased rapidly. Chinese President Xi Jinping's visit to Saudi Arabia as the first stop of his West Asia and North Africa tour in January 2016 demonstrated the Gulf region's position in China's overall diplomacy. As the strategic focus of West Asia and North Africa and a major component of the Arab world, the Gulf region will play an increasingly critical role in the implementation of the Belt and Road Initiative. Cooperation between China and the Gulf countries will also promote Sino-Arab cooperation.

The Gulf region is the engine of regional development, and also stands at the core of the entire Asia-Europe-Africa economic plate in the Belt and Road construction. Since the turmoil in West Asia and North Africa,

the Gulf states have become a prosperous “special zone” in stark contrast to other Arabian countries that have suffered severe economic downturn. The main reasons for this are threefold. First, the region is endowed with abundant energy reserves. The oil reserves of the Gulf region account for about 48 percent of the world’s total with a production life of another 78 years at low cost; natural gas reserves account for about 40 percent of the world’s total with a production life of another 264 years, while the global production life is only 67 years.<sup>2</sup> Second, the region occupies a strategic channel in the international trading route. The 1040-kilometer-long sea route, which extends from the west coast of the Persian Gulf via the Strait of Hormuz and the Gulf of Oman to the Arabian Sea, carries more than 50 percent of the world’s oil. Third, the region has strong economic power. The economic size of Gulf states accounts for about 50 percent of the Arab countries’ total, with their foreign trade volume accounting for about 60 percent and foreign investment about 70 percent.<sup>3</sup> It is also worth mentioning that the Gulf states own huge amounts of petrodollars. The total size of their sovereign wealth funds has reached US\$2.3 trillion, accounting for about 36 percent of the world’s total.<sup>4</sup> As China’s economy enters a period of “new normal,” characterized by the coexistence of momentum for economic growth and pressure of economic downturn, the Belt and Road Initiative will promote economic cooperation and connectivity between China and the Gulf countries. The Gulf states are not only China’s important partners to achieve its objective of steady economic growth, but also possess significant influence across West Asia, North Africa, and even inland Africa and Europe.

The Gulf region is foundation of stability in West Asia and North Africa and relations between China and the Gulf countries are key to the

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2 Yang Guang, “Strategic and Mutually Beneficial Economic and Trade Cooperation between China and Gulf Economies,” *International Economic Review*, No.3, 2014, pp.103-110. See more data at Chinese Ministry of Commerce, <http://www.mofcom.gov.cn/article/i/jyjl/k/201310/20131000367026.shtml>.

3 Xie Zhongmei, “Taking the Developmental Opportunities of Gulf Countries and Deepening Economic and Trade Cooperation,” *Essays from China-Arab Expo Seminar*, No.4, 2013.

4 “GCC Countries’ SWF Size More Than One Third of Global Total,” Chinese Ministry of Commerce, March 11, 2014, <http://www.mofcom.gov.cn/article/i/jyjl/k/201403/20140300513623.shtml>.

security of Belt and Road construction. Most Gulf states are still ruled by monarchies with more than one hundred years of family rule, which infuses these countries with a very distinctive cultural heritage and has contributed significantly to political stability. Such stability is exemplified clearly with the leadership change in the United Arab Emirates, Saudi Arabia and Qatar. A new generation of leaders, including Abu Dhabi Crown Prince and Deputy Supreme Commander of the UAE Armed Forces Mohammed bin Zayed Al Nahyan, Saudi Arabia's Deputy Crown Prince and Defense Minister Mohammad bin Salman Al Saud, Bahraini Crown Prince and Deputy Supreme Commander Salman bin Hamad Al Khalifa, and Qatar's Emir Tamim bin Hamad Al Thani, have successively managed a seamless power transition. Oman's Sultan Qaboos and Kuwait's royal Sabah family have also achieved solid ruling, and established a relatively stable succession mechanism. The six Gulf states, besides maintaining high living standards and social welfare for all, have worked to keep appropriate balance among legislative, executive and judiciary branches, and pushed forward reforms to address corruption. They have also promoted dialogue on religious tolerance, expanded civil rights and improved women's role and status. These changes have significantly enhanced social cohesion and national identity, and are welcomed by the majority of people. Political stability has provided a secure environment for foreign investment. Promoting relations with the Gulf states is conducive to improving security along the Belt and Road, combating the "three forces" of terrorism, separatism and extremism, and maintaining stability of China's western border.

## **Current State of Cooperation under the Belt and Road Initiative**

With the publication of *Vision and Actions on Jointly Building the Silk Road Economic Belt and the 21st-Century Maritime Silk Road* and China's first Arab Policy Paper, China and the Gulf states, based on the principle of wide consultation, joint contribution and shared benefits, have achieved significant progress in the Belt and Road construction.

## **High-level exchanges and cooperation mechanisms**

China attaches great importance to high-level exchanges and policy communication with the Gulf states, and the two sides have maintained a close and cooperative relationship. In January 2016, President Xi Jinping visited Saudi Arabia, Egypt and Iran, announced the first Arab Policy Paper, and signed 52 cooperation documents. During his meeting with the GCC's Secretary-General, Xi said, "China-GCC relations have been maturing. Cooperation between the two sides enjoys solid foundation and bright prospects. It is hoped that the two sides will forge ahead and pool more consensus to elevate the level of bilateral relations and promote China-GCC mutually beneficial cooperation to bring more benefits to the people of the two sides. China is willing to launch mutually beneficial cooperation with the GCC countries in combination with the Belt and Road construction, and realize the docking of respective development plans and strategies.<sup>5</sup> As of now, China has established strategic partnerships with Iraq, Qatar and the UAE, and comprehensive strategic partnerships with Saudi Arabia and Iran. In the China-initiated Asian Infrastructure Investment Bank (AIIB), Iran, Oman, Qatar, Saudi Arabia and the UAE are founding members. China has signed memorandums of understanding with Qatar, the UAE, Kuwait, Saudi Arabia and Iran to jointly build the Belt and Road, and has begun free trade area negotiations with the GCC and Iran respectively.

Promoted by high-level visits, China and the Gulf states have established a series of bilateral and multilateral cooperation mechanisms. For example, China and Saudi Arabia established a high-level joint committee in 2016, with six subcommittees in charge of political and diplomatic affairs, the Belt and Road Initiative, major cooperation projects, energy, trade and investment, and culture, technology and tourism respectively. The China-Arab States Cooperation Forum is a multilateral cooperation framework

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5 "Xi Jinping Meets with Secretary-General of Gulf Cooperation Council Abdul Latif Bin Rashid Al Zayani," Chinese Ministry of Foreign Affairs, January 20, 2016, [http://www.fmprc.gov.cn/mfa\\_eng/zxxx\\_662805/t1333528.shtml](http://www.fmprc.gov.cn/mfa_eng/zxxx_662805/t1333528.shtml).



Chinese high-speed railway products gain attention from Jordanian businessmen at the latest China-Arab States Expo held in Yinchuan, China in 2015. The 2017 Expo will be held from September 6 to 9, 2017 in the Chinese northwestern city.

with multiple levels and diverse content. Except Iran, all countries in the Gulf region are Arab states, representing an important and unique part of the Islam world. Since the establishment of the China-Arab States Cooperation Forum in 2004, the two sides' pragmatic cooperation have achieved leapfrog progress and the Gulf states have made outstanding contributions. At the sixth ministerial meeting of the Forum in June 2014, President Xi Jinping proposed the "1+2+3" cooperation pattern, taking energy cooperation as the core, infrastructure construction and trade and investment facilitation as the two wings, and three high and new tech fields of nuclear energy, space satellite and new energy as the three breakthroughs. In May 2016, the seventh ministerial meeting of the Forum identified connectivity, industrial capacity cooperation and cultural and people-to-people exchanges as the three pillars of Belt and Road joint construction, and allocated key areas and projects for cooperation.

### **Infrastructure connectivity**

Connectivity, as the basis of the Belt and Road Initiative, aims at linking land, sea, air and cyberspace environments of countries along the routes. Through six major economic corridors of China-Mongolia-Russia, New Eurasian Continental Bridge, China-Central Asia-West Asia, China-Indochina Peninsula, China-Pakistan and Bangladesh-China-India-Myanmar, China will be closely connected with Europe, Africa and the rest of Asia. While the Gulf states are well funded and in urgent need of infrastructure construction, China's experience and technology accumulated in its own development process could offer vital assistance. At present, the GCC is considering a regional railway network modeled on the European high-speed railway, which is composed of the Kuwait-Saudi Arabia-Bahrain line, the Bahrain-Doha line, the Saudi Arabia-Abu Dhabi-Al Ain line and the Muscat-Sohar line, etc., with a total mileage of 2,117 km and a total investment of about \$15.4 billion. It is expected to be completed in 2020. Chinese enterprises have actively participated in the above projects and other infrastructure such as ports, docks, industrial parks and oil pipelines.<sup>6</sup>

### **Traditional economic and trade cooperation**

The economies of China and the Gulf states are highly complementary. The two sides have deepened cooperation in the fields of energy, trade, project contracting and investment since the proposal of the Belt and Road Initiative. By the end of 2015, China has imported 110 million tons of crude oil from GCC countries, accounting for 75 percent of China's imports from Arab countries; the trade volume between China and the Gulf states has amounted to \$136.8 billion, which is 70 percent of total China-Arab trade; the value of signed labor service contracts between China and the Gulf states has reached \$102.8 billion. In 2015, the worth of completed project contracts reached \$11.55 billion, 7.56 percent of China's total turnover of overseas contracted

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<sup>6</sup> See more projects under construction by Chinese enterprises in the Gulf region at the websites of Chinese embassies in the Gulf countries.

projects, and the newly signed contracts amounted to \$11.87 billion. The total investment of non-financial projects between the two sides reached \$8.6 billion. From 2010 to 2015, Chinese investment in the Gulf states increased from \$430 million to \$1.97 billion, an average annual growth of 35.6 percent. At the same time, the GCC's investment in China is also on the rise.<sup>7</sup>

At present, the Gulf states have become China's largest source of oil imports, the second largest contracted labor market and the second largest engineering construction market in the world. Meanwhile, China is the eighth largest trading partner of the Gulf states. The continuous progress of Belt and Road construction will bring greater development space for bilateral cooperation in traditional fields. For example, the China-Arab States Expo has been held twice since its inception in 2013 and 163 projects with a total investment of 171.2 billion yuan have been signed at these events, including 86 foreign projects worth over 100 billion yuan and 77 domestic projects worth nearly 70 billion yuan. In addition, the China-GCC FTA negotiation was restarted in 2016. A comprehensive FTA would promote bilateral trade, facilitate investment and enhance mutual investment, which is conducive to the further internationalization of Chinese enterprises. The institutional cooperation between China and the Gulf states in the fields of service trade, financial investment and regulatory coordination is also helpful to constrain the attempt of the US and European countries to reshape the rules of global free trade.

### **Financial connectivity**

The Gulf states are in great need of infrastructure investment, but remain constrained by limited public financial resources. The input of social capital has not been satisfactory either. However, the Belt and Road Initiative provides the Gulf states with ideas and directions to change the traditional concept of relying on fiscal appropriation by strengthening international financial cooperation and innovating financing models, promoting

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<sup>7</sup> See more data at the Department of West Asian and African Affairs, Chinese Ministry of Commerce, <http://xyf.mofcom.gov.cn/article/date>.

development with projects that bring both social and economic benefits. In order to facilitate cross-border trade settlement and bilateral economic cooperation, China launched the renminbi's internationalization in 2009.

Driven inter-governmental cooperation mechanisms, the Gulf region's cross-border use, product innovation and offshore clearing centers of the renminbi have developed rapidly in recent years. The Gulf countries have become an important platform for the Chinese currency's internationalization. According to SWIFT statistics, from August 2014 to August 2016, the renminbi-denominated payment in the UAE has increased by 210.8 percent, and 81.4 percent of its transactions with Mainland China and Hong Kong were directly settled in the renminbi. In September 2016, the ratio of using the renminbi in direct payment between Kuwait and China has exceeded 10 percent. In 2012 and 2014, China signed bilateral currency swap agreements with the UAE and Qatar respectively, both with a scale of 35 billion yuan. In 2014, China established a renminbi clearing center in Doha, and as of April 2016, the total amount of business has amounted to 303 billion yuan.<sup>8</sup> In 2015, the People's Bank of China announced the expansion of the Renminbi Qualified Foreign Institutional Investor (RQFII) pilot scheme to the UAE. In addition, China has set up a \$20 billion co-investment fund with the UAE and Qatar, planning to jointly invest in traditional energy, infrastructure and high-end manufacturing in the Gulf region. China's policy-based financial institutions, commercial banks, the AIIB, and the Silk Road Fund have all provided special support for the Belt and Road projects, and the Gulf states are also actively exploring ways to establish or expand bilateral and multilateral cooperation funds.

### **People-to-people exchanges**

People-to-people exchanges are an important link between China and the Gulf states. The two sides have extensive interactions in the fields of

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8 Satish Kanady, "Qatar Renminbi Center Handles RMB 303bn Worth Transactions," *The Peninsula*, April 20, 2016, <http://www.thepeninsulaqatar.com/article/20/04/2016/Qatar-Renminbi-Centre-handles-RMB303bn-worth-transactions>.

scientific research, education, culture, health, youth, tourism and religion, providing a solid base of public support. The China-Arab States Friendship Year was held in 2014-2015, when the two sides signed an agreement on the first jointly-built university and started cooperation between 100 cultural institutions from both sides. At present, the number of Arab overseas students in China has been more than 14,000, and there have been 11 Confucius Institutes in Arab countries. The number of flights between China and Arab countries has also reached 183 per week. Specifically, there are 2,457 students from GCC countries studying in China, 3 Confucius Institutes in GCC countries, and 168 flights between China and the region. In addition, visa-free or visa on arrival policies have been implemented between China and Bahrain, Iran and the UAE's Dubai. In August 2016, China and Bahrain signed a memorandum of understanding on the establishment of a Chinese cultural center.

## **Reasons for Belt and Road Progress in the Gulf Region**

The major progress of the Belt and Road Initiative in the Gulf states is the result of joint efforts of China and the Gulf states following the trend of the times.

### **New opportunities presented by regional situation**

The Gulf region has witnessed sound development in recent years, and cooperation among major powers in the region has been on the rise, which has together brought about a relatively stable political environment for Belt and Road construction.

First, the US rebalancing strategy in the Asia-Pacific has been conducive to the promotion of the Belt and Road Initiative. In order to shift the United States' strategic focus toward the East, the Obama administration's posture in the Middle East has been restrained. One, accepting the Russian proposal of "chemical weapons for peace," and exhibiting unusual tolerance toward Russia's aggressive intervention in Syria. Two, refusing to dispatch large-scale ground forces to combat the ISIS. Three, releasing Iran from sanctions

despite opposition from Israel and Saudi Arabia. The US limited retreat from the Middle East has objectively allowed regional countries to look to the East. Meanwhile, it has reduced obstacles that had prevented China from entering the Middle East.

Second, the temporary US-Russia collaboration in West Asia and North Africa has benefited the implementation of the Belt and Road Initiative. With the recession of America and aggression of Russia in the region, the two countries have reached certain reconciliation to ensure their dominant status in respective “strategic pivotal states.” One, the global consensus on combating the ISIS has been reinforced. With the international community stepping up anti-terrorist operations at different levels, regional terrorist forces have suffered heavy losses. Two, thanks to international efforts for peace, parties involved in Syrian and Yemeni conflicts, while still in battle, have returned to the negotiating table, which has increased the possibility of a ceasefire and political dialogue. Three, the implementation of the Iranian nuclear agreement has been progressing smoothly, making it possible to rebuild regional peace and bringing new opportunities for China and Iran to jointly build the Belt and Road.

Third, the political stability of the Gulf states has provided a fundamental guarantee for Belt and Road construction. The six GCC states have been actively fighting against terrorism, preventing religious extremist ideologies from spreading, and effectively keeping under control the shock of Yemeni, Iraqi and Syrian conflicts on their societies. International organizations like the World Bank and the IMF, and rating agencies like the S&P, Fitch and Moody have been positive toward the Gulf states’ sovereignty credit and their commercial environment, holding that their systematic risk are low.<sup>9</sup> The overall high level of civilization in the Gulf states, with their high level of social welfare, low crime rate, and management of migrant

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9 In the World Bank ranking of ease of doing business index in 2015, the prospects of the six GCC countries’ commercial environment are all positive. In the World Bank’s 2017 ranking, the UAE and Bahrain are listed among the ten economies that have witnessed the most significant improvement. See more at the World Bank’s website, <http://www.doingbusiness.org/rankings>.

labors, has helped create a sound social environment.

### **Gulf states' eastward policy compatible with Belt and Road**

Most Gulf states are emerging and developing countries that are currently at the primary or acceleration stage of industrialization and urbanization. These countries are longing for social and economic development and accelerated industrialization to assuage domestic conflicts and avoid being left behind in the wave of globalization. To this end, they have been actively rolling out plans for long-term development, for instance, Saudi Arabia's Vision 2030 and National Transformation Program, the UAE's Vision 2021, Oman's Vision 2020, Kuwait's Vision 2035, and Qatar's and Bahrain's respective Vision 2030s. These countries are striving to achieve sustainable development by privatizing and developing non-oil industries. Among them, Saudi Arabia's reform is the most forceful. It aims to achieve economic transformation by 2020, and reduce its over-reliance on oil.

The Gulf states' economic structural adjustment and pluralistic reforms will bring about more business opportunities for the Belt and Road construction and foreign investment. Against the backdrop of the international financial crisis and low oil price, the Gulf states have looked to China and other emerging economies, showing strong interest in China's development pattern and governance, in the hope of taking advantage of Chinese experience, capital and technology to facilitate their domestic infrastructure construction and industrialization.<sup>10</sup> Oman's Ambassador to China Abdullah Salleh Al Saadi stated recently that China-GCC cooperation over the Belt and Road Initiative holds great development potential, and that the two sides should jointly promote such a grand strategy.<sup>11</sup> The Gulf states' eastward and China's westward policies have converged under the banner of Belt and Road, and their strategic synergy will bring brand new opportunities for both sides.

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10 Wang Lincong, "China's Belt and Road Construction in the Middle East," *Contemporary World*, No.9, 2015, pp.39-42.

11 "Gulf Arab Countries' Concerns about the Belt and Road Initiative," *The Paper*, October 24, 2014, [http://www.thepaper.cn/newsDetail\\_forward\\_1272780](http://www.thepaper.cn/newsDetail_forward_1272780).

## **Gulf states' unique potential in Belt and Road construction**

Energy security, industrial cooperation, infrastructure construction and financial cooperation are four major areas that are most promising for China-GCC joint building of the Belt and Road Initiative.<sup>12</sup> As a result, the Gulf region will provide new momentum for China's economic transformation.

First, for China, the Gulf states' oil and gas resources constitute a strategic guarantee for sustainable development. Even though China is endeavoring to change its economic growth pattern and facilitate the structural transformation of its energy demands, it still needs to rely on sustained fossil energy supplies in the short term. The continuously sluggish international crude oil price and the relatively high cost of domestic oil exploration have resulted in decreasing crude oil production in China since 2016, and an increase of foreign dependence to 63.8 percent.<sup>13</sup> The Gulf states, especially GCC countries, have been major sources of China's oil imports. According to China's General Administration of Customs, China imported 381 million tons of crude oil in 2016, a record high since 2011; of this total, 115 million tons were from GCC states, accounting for 30.2 percent.<sup>14</sup> China's demand for natural gas is also on the increase. In 2016, China surpassed South Korea and became the second largest importing country of liquefied natural gas. It is expected that by 2020, China's natural gas consumption will amount to 400 billion cubic meters. With its production volume reaching 220 billion cubic meters and imports rising to 180 billion cubic meters, the foreign dependence will reach 45 percent.<sup>15</sup> The GCC states are an important guarantee for China's natural gas imports. Of these countries, Qatar and the UAE are China's third and

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12 Yang Guang, "Joint Belt and Road Construction in the Middle East: Economic and Security Perspectives," *Annual Report on the Development of the Middle East*, No.18 (2015-2016), [http://tt.cssn.cn/zk/zk\\_zkbg/201611/t20161117\\_3280150\\_2.shtml](http://tt.cssn.cn/zk/zk_zkbg/201611/t20161117_3280150_2.shtml).

13 "Foreign Oil Dependency Up," *China News Service*, January 13, 2017, <http://www.ecns.cn/business/z/2017/01-13/241517.shtml>.

14 Data for the GCC countries is the sum of data for individual members. See more at Customs-Info, <http://www.customs-info.com>.

15 He Zhiming, "Current Situation and Contradictions of China's Natural Gas Market," *Oil Observer*, May, 4, 2014, <http://www.oilobserver.com/tendency/article/632>.

fourth largest importing sources in 2016. Looking at the general trend, China's economy remains on an upward trend; the Belt and Road Initiative progresses apace; the trade for non-state-owned crude oil has been deregulated; domestic crude oil production continues to decline; and China's demands for oil imports remain robust. Meanwhile, with the guidance of domestic policies and mounting pressure for environmental protection, the utility of natural gas is increasing and the supply will be in shortage over the long term. The Gulf region, with abundant oil and gas resources and convenient exploration and transportation conditions, are able to satisfy China's surging demands and could be a crucial guarantee for China's oil and gas imports in the foreseeable future.

Second, as Chinese enterprises go global, the Gulf region will be a major destination of China's advantageous production capacity. China and the Gulf states are all at a critical stage of economic transformation, and the huge complementarity among the economies will facilitate further cooperation in many areas. To reduce reliance on the oil industry, the Gulf states are promoting industrial diversification. China has a comprehensive industrial system and strong manufacturing capabilities. If it combines its relative strengths in industrial capacity with the Gulf states' resources, geography and market opportunities through the Belt and Road Initiative, both sides will achieve substantial benefits. The Gulf states' demands for infrastructure construction will remain robust, and in the next decade, the six GCC countries' total value of planning projects will reach around \$2 trillion. Of these countries, Saudi Arabia plans to invest \$45 billion in building a national railway network; the bidding value of Kuwait's major projects has already reached \$30 billion; the investment in infrastructure and urban construction of the UAE for hosting the 2020 World Expo is expected to be \$18.3 billion; Qatar, for hosting the 2022 World Cup, will invest more than \$205 billion in infrastructure construction.<sup>16</sup> In addition, the Gulf states have all launched infrastructure projects such as island development, railway

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16 2“Gulf Countries' Planning Projects Reach \$2 Trillion,” Chinese Ministry of Commerce, June 13, 2016, <http://www.mofcom.gov.cn/article/i/dxfw/gzgd/201606/20160601337273.shtml>.

construction, airport expansion, urban renovation, and free trade zones. Kuwait plans to invest \$130 billion to build a “Silk City” on its northern coast; Oman plans to build the Duqm economic special zone in its Al Wusta Governorate, and has expressed an unequivocal willingness to cooperate with China.<sup>17</sup> As the director of the State Council Development Research Center Li Wei pointed out, there is a convergence of interests between the GCC’s economic diversification strategy and China’s initiative of international industrial cooperation. The two sides should utilize their respective comparative advantages, reinforce each other through wide consultation and joint contribution, to facilitate bilateral economic cooperation and the Belt and Road construction while pushing forward the optimization of the two sides’ economic structures.<sup>18</sup>

Last but not least, China has made the Gulf region an important “experimental zone” for the renminbi’s internationalization. In recent years, the continuously sluggish international oil price has magnified the capital strain and put increasing fiscal pressure on the Gulf states, which has presented China with a historic opportunity to facilitate the renminbi’s internationalization. As China and the Gulf states cannot alter the current situation of energy supply and demand in the short run, the drawbacks of using a single currency (the US dollar) in oil exports have become obvious. To achieve greater market share in China than Russia, the Gulf states are attempting to use the renminbi in their settlement of oil trade. Since September 26, 2016, the renminbi has been directly tradable with the Emirati dirham and the Saudi riyal. As major oil producers in the Gulf region, Saudi Arabia and the UAE accepting the renminbi in settlement will encourage other Gulf states to use the Chinese currency and reduce the sometimes turbulent ramifications of a fluctuating international oil price on China’s oil industry. Furthermore, the acceptance will expand the renminbi’s

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17 Wu Sike, “Belt and Road: Voices from the Middle East,” April 9, 2015, [http://www.china.com.cn/opinion/think/2015-04/09/content\\_35277076.htm](http://www.china.com.cn/opinion/think/2015-04/09/content_35277076.htm).

18 “New Blueprint for Industrial Cooperation between China and Gulf States,” *People.cn*, <http://theory.people.com.cn/n1/2017/0210/c83853-29072824.html>.

scope of application, and at the same time safeguard the use and reserve values of the renminbi in the international market.<sup>19</sup> Meanwhile, China's launching of the RQFII trial in the UAE and Qatar, with 50 billion and 30 billion yuan of investment limit approved respectively, will expand the investment channels of renminbi holders in the Middle East and increase the currency's attractiveness in trade settlement. However, since China's capital market is not yet sound and the openness of capital account is limited, outbound renminbi can only flow back to China through RQFII and other limited channels, which adds difficulty to the renminbi's reflow. Besides, the renminbi's use in trade settlement in the Gulf states is just at the early stage without widespread application.<sup>20</sup> Therefore, China should seize the opportunity brought by the implementation of the Belt and Road Initiative and low international crude oil price, and adopt a gradual approach to promote the renminbi's use in trade settlement.<sup>21</sup>

## Challenges of Belt and Road Construction in the Gulf Region

Thanks to its unique geopolitical position, the Gulf region has been a global energy base and a continent of hope, but it is also a region rife with ethnic, religious, and political conflicts. Regional turbulence and political rivalry among major powers add to challenges and uncertainties of cooperation between China and the Gulf states.

**Geopolitical risks.** West Asia and North Africa are experiencing the most profound transformation since the turn of the century. First is the adjustment of US-Russia relations. Russia, taking advantage of the US eastward strategic rebalancing, dispatched its troops to Syria and involved itself in the complicity of regional conflicts. There has been a trend of

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19 Wang Yu, Wang Likun, Xu Siyuan and Zhang Huiyan, "Opportunities and Challenges of the Renminbi-Denominated Oil Pricing System," *Futures and Financial Derivatives*, May 2016.

20 Chen Zhi, "Chinese Banks Face Challenges in Overseas Expansion under Belt and Road," *21st Century Economic News*, December 22, 2016, [http://epaper.21jingji.com/html/2016-12/22/content\\_53295.htm](http://epaper.21jingji.com/html/2016-12/22/content_53295.htm).

21 Gao Bo, "Reinforcing China-Arab Financial Cooperation to Support Renminbi Internationalization," *China Bond*, October 12, 2015, <http://www.chinabond.com.cn/Info/22061365>.

US recession and Russian aggression in the region. Further changes will take place in America's regional policy and the US-Russia relations under the Trump administration. Second is the all-out confrontation between Saudi Arabia and Iran. As two major countries in West Asia and North Africa, Saudi Arabia and Iran not only represent the Arab and the Persian ethnic groups respectively, but are also leaders of Sunni and Shia in the Islam world. Therefore, the competition between the two sides is one for ideological influence, aimed at gaining regional control. The two countries' proxy battles in Iraq, Syria, Yemen, Lebanon, among other regional conflicts, have exacerbated regional tensions and the Islam world's breakdown. Third is the reshuffling of international relations across the region. Under the influence of the afore-mentioned two factors, US allies such as Israel, Saudi Arabia, Turkey and Egypt have shown a centrifugal tendency and engaged with Russia. Egypt, Saudi Arabia, the UAE and Turkey are becoming closer to Israel, while Egypt and Turkey have reversed their stance on the Syrian issue. As regional order and international relations are yet to reach a new equilibrium in the process of disintegration, such restructuring could easily trigger geopolitical conflicts, and lead to increased uncertainty and risk in the Belt and Road construction. Fourth is the further escalation of certain hotspot issues. Syria, Iraq, Libya, Yemen, ISIS and the Iranian nuclear issue, among others, have added significantly to an already very tense situation in the Gulf region, and also posed threats to cooperation in bilateral trade, investment and engineering contracts.

**Economic risks.** The Gulf states are all governed by monarchies. At the primary stage of industrialization, they are susceptible to US and European influence. Therefore, the Belt and Road construction faces both internal and external restraints. First is the high barrier of market access. Business in the Gulf region has been struggling due to bureaucratic corruption and royal monopoly. On the one hand, the red tape in the government's approval process jeopardizes the progress and profitability of projects. On the other hand, the government has kept import under control. Chinese enterprises have no obvious price advantage in the ratings and evaluation of

foreign enterprises and undergoing contracted projects. Second is the fierce competition with other countries. The Gulf states, having dealt with the US and European countries for a long time, tend to recognize Western standards in planning and design, production and operation, and quality supervision. In the traditional civil engineering field, China is also facing competition from other developing countries like India and Turkey. The comparative advantage of Chinese enterprises is relatively weak. Third is the bottleneck in project funding. Infrastructure projects has generally low profitability, long period for return on investment and strict government monitoring; so private investment and available financing channels are limited. As most Gulf states are under great fiscal pressure, their investment capabilities are so weak that it is hard to meet their financing demands only by relying on the AIIB and the Silk Road Fund. Fourth is the issue of labor interests. Chinese enterprises, as they go global, are in need of more and more local labors. However, lack of knowledge about local regulations and deficiencies at the operational level have led to the rise of labor and economic disputes.

**Religious and cultural risks.** In the Gulf region, Islam holds a dominant position. As a religion and a cultural value system, Islam has profound bearings on local society and economy. With the expansion of Belt and Road construction, there would be inevitable interactions between Chinese and Islamic cultures. The two sides' relatively large cultural and cognitive differences due to discrepancies in religion and language would affect people-to-people exchanges and the development of bilateral relations. Moreover, through the Belt and Road, Islam might penetrate eastwards and reinforce the religious awareness of local Muslims. For instance, in China's northwestern region, Islam has taken on features of Wahhabism. Religious fanaticism might be stirred up by people with ulterior motives to instigate conflicts between religious and secular worlds, which could easily lead to the emergence of violent or terrorist activities. The Gulf region has long been the base camp for Al Qaeda, ISIS, and other terrorist groups. Though ISIS has been heavily defeated thanks to joint efforts of the international community, it is unlikely to be wiped out in the

short term as its outward expansion is still underway, which poses threats to regional security. As the Belt and Road Initiative proceeds, there is possibility that extremist groups and criminals might hijack Chinese people for their own political or economic ends.

## **Approaches to Promoting Belt and Road in the Gulf Region**

The Belt and Road Initiative has provided a platform for deepening and expanding relations between China and the Gulf states. A common demand for development necessitates close bilateral relations. In spite of challenges, risks can be turned into opportunities as long as we face them up squarely and respond positively.

**Strengthening policy coordination and enhancing mutual trust.** High-level exchanges between China and the Gulf states have been frequent and mutual political trust has been further enhanced. While maintaining interactions with Saudi Arabia, the UAE, Iran and other major Gulf powers, China should increase high-level visits and contacts with small and medium Gulf states, increasing mutual understanding and support on issues of core interest and major concern. First, the two sides should strengthen coordination on regional affairs, such as Syria, Yemen and the Iranian nuclear issue, and continue to promote political solutions to hotspot issues. Second, the two sides should improve bilateral and multilateral mechanisms, such as the China-GCC free trade area and the China-Arab States Cooperation Forum, and make full use of bilateral high-level joint committees and sub-committees to implement strategic synergy. Third, the two sides need to establish dialogue mechanisms with countries outside the region, thereby transforming the cooperation momentum of individual parties into an assurance for sustained stability. Under the right concept of morality and interests, China and the Gulf states should aim to jointly build a community of common interests on the principle of wide consultation, a community of shared responsibility on the principle of joint contribution, and a community of common destiny on the principle of shared benefits, to assist the Belt and

Road construction.<sup>22</sup>

### **Building the Gulf corridor and linking the West Asian Silk Road.**

Of the six economic corridors of the Belt and Road Initiative, there is one overlapping with the New Eurasian Land Bridge, extending from Alataw Pass and Khorgos on the China-Kazakhstan border to Turkey via Uzbekistan, Kyrgyzstan, Tajikistan, Turkmenistan, Iran and Iraq. Different from the Eurasian Land Bridge highlighting railway advantages, this economic corridor is the area that China's oil and gas pipelines must pass through. With the extension of Belt and Road construction, the China-Central Asia-West Asia economic corridor will continue to extend to the Gulf countries such as Saudi Arabia, Iraq and Iran. If a Gulf corridor is built and connected with the China-Pakistan Economic Corridor to form the West Asian Silk Road, China's energy security will enjoy maximum protection. This West Asian Silk Road will further stretch along the Mediterranean coast and beyond through the Arabian Peninsula, enriching and extending the connotation and space of the Belt and Road and perfectly linking Asian, European and African economic circles.<sup>23</sup>

### **Improving trade and optimizing industrial capacity cooperation.**

China is the most important trade partner of the Gulf region, but trade between the two sides is still at a low level: the proportion of energy is high while the export of China's high value-added and technology-intensive products is small, and there are few landmark cooperation projects. Although cooperation between China and the Gulf countries has extended from traditional industries and infrastructure construction to retail, finance, telecommunications and tourism, there is still great development space in industrial policy, industrial layout and the cultivation of key industries. First is to synergize development strategies. The two sides need to expand areas of industrial capacity cooperation, and focus on major projects such as ports,

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22 Tian Wenlin, "Belt and Road Initiative and China's Middle East Strategy," *West Asia and Africa*, No.2, 2016, pp.127-145.

23 Qian Xuewen, "West Asian Silk Road Construction in the Perspective of Belt and Road Initiative," *Arab World Studies*, No.1, 2016, pp.83-96.

logistics and industrial parks to achieve early harvest. Second is to balance investment. The Chinese projects should not only concentrate on countries with rich energy resources, strong consumption capacity and great regional influence such as Iran, Saudi Arabia, and the UAE. China should also speed up the perfection of regional industrial layout. Third is to carry out third-party cooperation. Avoiding fighting alone in the bidding and construction of major projects and cooperating with other international companies or local enterprises would reduce the burden and share the benefits.

**Enhancing financial cooperation.** Well-funded with petro-dollars, the Gulf countries are one of the most important long-term sources of capital in the international community. The strategic importance should not be underestimated. The following forms of cooperation could be adopted: setting up local branches, strengthening contact with local peer industries, carrying out bank-enterprise cooperation, and cooperating in the capital market by issuing bonds, equity financing or establishing cooperative funds. China and the Gulf states could explore cooperation in the following areas. First, diversifying financing to break the funding bottleneck. On the one hand, there are multilateral institutions such as the AIIB, the Silk Road Fund and the BRICS New Development Bank to establish a benefit and risk-sharing decision-making mechanism. On the other, there are a variety of financial products, such as external guarantee, mixed loan and the Silk Road bonds to open up financing opportunities through innovation. Second, increasing business outlets to improve the geographical layout across the Gulf region. The number of branches of Chinese commercial banks in the Gulf region is seriously lagging behind the expansion of Chinese enterprises. It is difficult for Chinese financial institutions to provide comprehensive services to the enterprises, and thus assistance from the Gulf countries is necessary. Third, understanding financial regulations and training qualified professionals. The Gulf region is the core area of Islamic finance, which requests compatibility with the teachings of Islam and thus has a strong moral orientation, emphasizing a fair, equitable partnership that shares both profits and losses. To integrate with the Islamic financial model, familiarity

with Islamic teachings and commercial regulations in Islamic countries is necessary besides professional knowledge and skills.

**Reinforcing risk prevention and establishing crisis management.** In order to address the risks associated with the Belt and Road construction, it is necessary to set up issue-specific security and risk assessment mechanisms to be forewarned of possible crises and prevent unnecessary setbacks. First, it is imperative to undertake detailed homework. China should further its understanding of the situation in the Gulf countries, analyze the political and security risks therein, grasp the direction of policy changes, the commercial and cultural environment, the fiscal and taxation system as well as the legal regime of target countries, and establish a knowledge system of risk prevention. Second, China should establish mechanisms to carry out joint anti-terrorist operations. It is necessary to strengthen intergovernmental exchanges of intelligence through bilateral or multilateral channels, and share the responsibility with relevant countries to build a long-term win-win security mechanism. Third, China should enhance security protection and promote corporate governance in accordance with law. Chinese overseas enterprises could employ local or international lawyers, and insist on payment with letters of credit or the combination of prepayment and collection. They should also take advantage of foreign aid to promote settlement in the renminbi, and cooperate with overseas security companies to reduce legal and payment risks, to safeguard the property and personnel safety of overseas enterprises.

**Deepening exchanges to achieve closer people-to-people bonds.** First is to guide religious interactions. Normal exchanges among religions are not only important for people-to-people bonds, but are also effective in addressing the spread of extremism. Second is to voice the Chinese opinion more actively. China should demonstrate due guidance in its engagement with the Gulf states to build a friendly foundation of public opinion. Third is to strengthen think tank dialogues. Domestic think tanks should try to go beyond the traditional departmental and regional divisions and carry out joint research, and at the same time develop interactions and exchanges with foreign think tanks. 