Wars & Walls of the Dragon: China's Geopolitical Ties and Sanctions Risks in the Middle East

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As a result of the ongoing trade war between the United States ('**US**') and China, a web of new dynamics has ensnared the international system, giving rise to new forces, tensions and breaks, that are in turn causing wide-reaching consequences across

political, economic and legal spheres, and impacting the global economy. Trade relations represent just one juncture of these interconnected fields, and yet entail multifaceted and nuanced ramifications across the global business market.

China is becoming increasingly prominent as a regional strategic partner; as its energy security and Belt and Road initiatives drive its investments and interests in the Middle East, the national development visions of regional countries have created a symbiotic drive for opening up to international investors. In 2017, China overtook the US as the leading investor in Saudi Arabia, rendering it the primary trade partner for the Region's top two economies – both Saudi Arabia and Iran. The Middle East's central location also increases its significance in China's global expansion plans; the UAE alone sees up to 60 percent of China's trade with Europe and Africa which passes through its ports in transit to the Eastern hemisphere. With emerging alignment between the interests of China and regional countries, it is perhaps not surprising that trade ties between the region and the largest economy in the world have proliferated. Yet with China's current trade troubles that have flared in its competition with the US, Middle Eastern countries may be increasingly exposed to disturbances in global trade dynamics caused by rising tensions beyond their borders.

The dominant forces that are currently disrupting China's trade flows at the global level can largely be attributed to two sources: political tensions and legal mechanisms. The Middle East region is one that is often described as being volatile, but events that are currently unfolding across the global stage reveal that destabilising forces do not discriminate on the basis of geography.

Trade Wars: The Spill-Over Effect of US-China Tariffs

Political tensions are the driving force behind the ongoing US-China trade war, which has been escalating since President Trump implemented tariffs on imported steel and aluminium (for all nations, not only China) on 9March 2018. This policy was borne out of the protectionist 'America First' rhetoric that has pervaded the objectives of the current White House administration, though tariffs imposed by targeted countries in response have also cost the US economy. China responded by imposing a $3 billion tariff on US imports, prompting an escalatory chain of measures that resulted in the US and China jointly imposing almost $350 billion in tariffs. The tension between the US and China has subsequently calmed, with both countries having reached a détente, and President Trump pledging to indefinitely freeze the imposition of 25 percent tariffs pending negotiations over a new comprehensive trade deal between the two countries.

Despite the bilateral narrative surrounding the USChina trade war, in the event that the negotiations for a new deal should fail and elevated tensions spark a fullblown trade war, the World Economic Forum estimates that it could reduce global Gross Domestic Product ('**GDP**') growth by as much as 0.7 percent, negatively impacting economic development across every continent. This is based on a worst-case scenario of a US 25 percent tariff on $505 billion imported by China, and a corresponding increase by China of 50 percent of that total. In an equally pessimistic outlook, the International Monetary Fund ('**IMF**') cut its forecast for GDP growth based on tariffs that had been imposed by October 2018, predicting that GDP growth would grow only 3.7 percent over the course of 2018-2019, 0.2 percent lower than its forecast of just three months earlier in July 2018.

Importantly, the US is not only pressing trade disputes with China but has approached re-negotiations of several of its major trade agreements in a way that has brought it to adversarial ground with several historic major trade partners, including Canada, Mexico, and the EU. The sheer scale of the tariffs and magnitude of commerce impacted at the global level makes it inevitable that such disruptive practices have spillover consequences far beyond the borders of the US or China.

Caught in the Middle East: Key Sectors Feeling the Heat?

Both the US and China are key strategic trade partners of many Middle Eastern counties. The US has a long history of diplomatic and commercial involvement in the region, whilst China's continuing rise to global prominence has necessitated stronger ties with energy-producing nations. In July 2018 at the 8th Ministerial Meeting of China-Arab States Cooperation Forum, China pledged a loan package worth $20 billion to Middle Eastern nations to boost oil and gas development, enhancing relations that have already been intensified through China's pursuance of its strategic Belt and Road initiative. Both of these countries represent significant investors with deep ties to the region across politics, trade and foreign affairs.

As a result, though not directly targeted by the tariffs, knock-on impacts have been felt to an extent across a number of sectors. The aluminium industry for example, is one where the UAE is exposed to the imposition of the US' 10 percent tariff, as the third largest exporter to the US, accounting for 13 percent of aluminium imports behind only Canada and Russia (with 54 and 17 percent respectively). Qatar, Saudi Arabia and Bahrain are also amongst the top 10 exporters of aluminium to the US, with oil fuelling cheap production. Despite this, the UAE steel industry has been relatively insulated from the trade dispute, as it exports only five percent of its aluminium to the US. Other business leaders from the UAE's industry have also reported increasing practical difficulties in trading with China, impacting overall growth and placing additional burden on the national economy.

This does not necessarily mean however, that the consequences will be negative for all markets. The region is largely shielded by its status as a net exporter of hydrocarbons and some markets are well positioned to benefit from shifting trade flows. Saudi Arabia, for example, has taken specific steps to develop its solar energy industry, increasing its attractiveness as a manufacturing destination for Chinese companies looking to avoid the 40 percent tariff levied by the US against all solar imports.

The ability of targeted countries and businesses to shift their global operations in order to avoid negative measures represents a key distinction between trade tariffs and trade sanctions. Whilst the extent and magnitude of the trade war that rose to a crescendo in 2018 has indubitably impacted trade flows through and around the Middle East, the risks involved are largely geopolitical and commercial in nature. By contrast, trade sanctions carry additional legal and reputational risks that are also instrumental in diverting global trade flows.

Trade Walls: China's Interactions with Economic Sanctions

Economic sanctions, due to their targeting and selective application, do not yield the same economic clout as the tariff war between two global trade titans. Their application, however, and the punitive sanctions that they carry, can amass devastating damage on small economies and private businesses that fall on the wrong side of the law.

The current international economic sanctions framework is currently delineated by the fragmented remnants of the Joint Comprehensive Plan of Actions ('JCPOA'), also known as the 'Iran Deal'. On 8 May 2018, President Trump announced that the US was pulling out of the Iran Deal, that had been agreed between the permanent members of the UN Security Council (UK, China, Russia, France, US, the EU, Germany and Iran), on 16 January 2016. Following the announcement, the US President provided a National Security Presidential Memorandum directing preparation for the reimposition, or snap-back, of all US sanctions that had been lifted or waived following the Iran Deal. 4 November 2018 was set as a hard deadline for all US persons to wind up their dealings with Iran. In effect, this means that both primary sanctions covering all US persons, as well as secondary sanctions against non-US persons, are in full effect across a range of prohibited activity.

The new position of the US is at odds with that of the other signatory parties of the Iran Deal, with EU

countries resolved to salvaging some protection for European companies dealing with Iran. The diversion in approaches adopted by major geopolitical players to trade with Iran adds tension to an already sensitive situation and is a further issue that will test both political and business relations in the Middle East. In this context, China's ongoing trade with Iran is likely to prove a flashpoint for its future activity in the Middle East.

The direct effect of the US' position means that secondary sanctions, namely sanctions that impact non-US actors that interact with Iranian entities, have been re-imposed and will likely lead to non-US actors being subject to censure and punitive action from the US. Although China is currently permitted to continue exporting oil from Iran under its temporary waiver granted by the US to eight of Iran's key oil exporters, China may need to re-evaluate its position when the waiver expires on 1 May 2019. The US has indicated that it will not renew any of the waivers and will continue to pursue its 'maximum economic pressure' campaign by driving Iran's exports down to zero. Although China has reiterated its commitment to developing strategic ties with Iran, China's continued reliance on energy imports has formed the basis of its trade relationship with Iran and it is unclear how it will maintain its current oil-dominated relations once it becomes subject to the full extent of US sanctions.

As a primary obstacle, any trade in Iranian oil which is financed by transactions passing through the sanctioned Central Bank of Iran will become subject to secondary sanctions, which carries daunting concerns for China's financial institutions. Moreover, the Chinese state-owned Bank of Kunlun, which channels a large proportion of China-Iran trade transactions announced its new policy in January, stating that it would only service trade in goods exempt from sanctions, in full compliance with the US legal restrictions.

The ability of the US to use economic sanctions as a means to influence trade between third party countries, despite a lack of alignment between their respective foreign policy agendas, has caused some countries to explore ways in which to increase their economic sovereignty against the pressure of US sanctions. The UK, France and Germany, for example, as signatories of the JCPOA, recently established the Instrument in Support of Trade Exchanges ('**INSTEX**'), a Special Purpose Vehicle ('**SPV**') designed to facilitate compliance trade between EU and Iranian companies through a mirror-transaction system. Though the practical and legal minutiae of the SPV are yet to be determined, and it is not clear whether any such vehicle would be capable of facilitating trade between Iran and third party countries, it is an important example of how countries are attempting to mitigate the stranglehold of US sanctions.

In a further example, at the end of March 2019, the China International Payments System ('**CIPS**') reportedly attracted several Russian banks with a view to boosting bilateral relations between Russian and China, including the use of their respective national currencies (ruble and yuan respectively). Though this is a relatively nascent development, considering the challenges imposed by US sanctions not only on Iran but also on targeted Russian entities, it may prove useful as an alternative mode of payment in the future, moving away from reliance on the US dollar dominated financial system and towards greater multilateral economic sovereignty.

With an elevated risk of sanctions infractions, the high cost of compliance, and facing the deterrence of secondary sanctions, the US upending the JCPOA will radically undermine the appetite and ability of Chinese businesses, as well as companies based in the Middle East and beyond, to trade with Iran. Repercussions from the US' withdrawal will not be confined to entities that trade with Iran, as collective fear of punitive measures will osmose into the global financial system, spurring development of alternative means to facilitate trade without invoking trade sanctions.

Critically, unlike with the migration of business activity based on the commercial drivers of trade tariffs, any means that are perceived to be aimed at circumventing sanctions measures carry far greater legal risk and the full weight of punitive fines. Delineating between activity that is legitimately risk-avoidant rather than illicit is a fundamental requirement of modern compliance programmes.

Untangling Sanctions and Tariffs: The Saga of China's Telecom Giants

Although trade tariffs and sanctions are distinctly different mechanisms for influencing economic flows, there are instances where their application can become conflated, blurring the lines between legal and geopolitical restrictions. This is exemplified by recent high profile activity surround the US government and China's telecommunications giants.

Historically, the US has set precedence for applying punitive measures against Chinese telecoms' companies, including punitive fines for sanctions infractions, as well as strict export restrictions on US-origin componentry sold to a specific Chinese telecoms company. Most recently, the US has waged an extensive campaign against one of China's flagship telecoms' companies, taking extreme measures to curtail its global commercial activity. This incorporated a range of measures including arresting and extraditing the company Chief Financial Officer from Vancouver, Canada, banning all US government branches from purchasing and using goods produced by Chinese telecoms' companies, and conducting a concerted diplomatic campaign across Europe to persuade its allies to impose a ban against use of technology produced by the company in question in development of 5G networks on the basis of national security concerns. Press reporting on the matter has recently included speculation that impending measures may include US sanctions measures against the company, even though there has been no official confirmation of any such plans to date.

Whilst President Trump has insinuated a political basis for this activity, and pending the outcome of a comprehensive US-China trade agreement under discussion by both countries, Middle Eastern markets have already responded to the risk of impending increased difficulty in trading with Chinese telecoms' companies. In the event that sanctions measures are imposed against targeted companies, these would pose significant difficulties for Middle Eastern markets, which are largely reliant on Chinese supply of componentry for telecoms' networks.

As long as the prospect of sanctions measures in this matter remains speculative, companies are not subject to any further legal restrictions regarding trading with Chinese telecoms companies. Businesses and governments would be well-advised however, to monitor any developments for significant shifts in the risk climate.

Keeping an Eye on the Dragon: Middle East-China Trade Ties in Future

For Middle Eastern businesses that are endeavouring to predict their place in the storm of trade tensions and restrictions, it is critical that business leaders are aware of how global dynamics influence regional trade flows. Against the backdrop of China's intensifying diplomatic and trade ties with the region, increasing inflows of investment and commerce from the East will likely raise concerns surrounding the strategic balance between US and Chinese interests with key strategic allies. Such considerations will become increasingly important as regional governments focus on securing sufficient inflows to their respective countries in pursuance of their development strategies, such as the Bahrain Economic Vision 2030, KSA Vision 2030 and Egypt Vision 2030. These visions are contingent upon sufficient funding, and efforts by regional countries to develop trade ties within international investors which will likely increase their exposure to shifts in global trade flows.

As high profile developments currently exhibit, the dynamics of trade wars and walls can create an intractable nexus of forces that shape cross-border trade, the impacts of which can dissipate to be felt at the micro-level. Ultimately, despite the seeming remoteness of such threats, it is imperative that all businesses, whether operating in the Middle East or elsewhere, stay apprised of developments on an international level which may impact business conditions and make an effort to ensure that they are aware

of where the lines between commercial and legal risks merge.