

Opportunities and Challenges of China-Middle East Countries' Production Capacity Cooperation

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Abstract: *The Middle East is a region where China has more advantages in production capacity cooperation. China started early and has a good reputation in the area of engineering contracting, which has laid good foundations. At present, the Middle East countries are in an important stage of economic transformation. In order to accelerate industrialization, they have developed long-term economic development plan, which provides an important historical opportunity for Chinese enterprises to establish business there. The production capacity cooperation between China and the Middle East countries will utilize the complementary advantages and adhere to mutually beneficial and win-win spirit, and thus has been welcomed by the Middle East countries. At present, the two sides are carrying out fruitful cooperation in infrastructure, high technology and labor-intensive industries, and have achieved significant results. The production capacity cooperation between China and the Middle East countries are facing both opportunities and challenges. We should make good use of opportunities, prevent and resolve risks, and effectively do a good job in production capacity cooperation between China and the Middle East*

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countries

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Promoting international production capacity cooperation is a major move for the Chinese government to promote a new round of opening up to the outside world and enhance the international competitive advantage. It is not only conducive to coordinating China's domestic and international situations and enhancing the level of the open economy, but also in favor of the implementation of the "One Belt and One Road" initiative, deepening cooperation between China and the countries involved, and promoting local economic and social development, necessary to promote the "One Belt and One Road" initiative. From all aspects of the conditions, the Middle East is a region where China has more advantages in production capacity cooperation.

I. The Middle East is the Traditional Market of China's Overseas Engineering Contracting

Since the beginning of the 1990s, China has collaborated with Sudan, Iran, Turkey, and Egypt in the field of petroleum, transportation, and investment, and has accumulated many successful experiences, which serve as models for the future expansion of production capacity cooperation between China and the region. Sudan is rich in oil reserves. In 1995, the China National Petroleum Corporation (CNPC) and the Sudanese government signed agreements on the exploration and development of oil products, then, CNPC took over the projects on transportation pipeline of crude oil and joint venture on construction of Khartoum oil refinery project. After more than ten

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years of efforts and with the help of China, Sudan has established an industry system with the integration of upstream and downstream industry and the modernization of the petroleum industry, and has become a country with the rapid development of industrialization. The CNPC has trained a large number of engineers and technical and management personnel for Sudan, providing more than 80,000 jobs for the local employees, and also built hospitals and schools, drilled wells, and paved roads for local residents; it has done a lot of work to improve the livelihood of the people. Petroleum cooperation between China and Sudan truly reflects the sincere cooperation and mutual benefit and win-win concept, not only finds a way to economic and social development driven by resource development for less developed countries such as Sudan, but also provides an example for China and other countries to carry out production cooperation.^① Tehran Metro Line No. 1 and Line No.2 in Iran are two major projects led by the Chinese companies in the Middle East in the 1990s. The project used Chinese standards, overcame difficulties, and won the praise of the Iranian government and people with affordable, safe and reliable characteristics, and laid the foundation for China to expand foreign markets in construction of urban railway transit. In July 2014, the 156-km section of the high-speed rail connecting Ankara and Istanbul in Turkey, which was constructed by Chinese companies, opened to traffic successfully, marking China's high-speed rail technology and vehicle equipment and technology successfully accepted by Turkey, a country which adopted the high European technical standards. This is the first time for China's high-speed rail technology to "go abroad", which is of

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important significance to promote China's high-speed rail to further "go out". The construction of the China-Egypt Suez economic and trade cooperation zone started in September 2008. It is one of the key projects in China's "going out" strategy, and also a National Foreign Economic and trade cooperation zone confirmed by the Chinese Ministry of Commerce. At present, most of Chinese enterprises making investment in Egypt settle there, and has thus had an inducement effect. After the completion of the economic and trade cooperation zone, it will create 40,000 employment opportunities for Egyptians, and will play a greater role in Egypt's industrial upgrading, export, and taxes, which is a typical example of Sino-Egyptian cooperation and win-win cooperation.

II. The acceleration of the Industrialization Process in the Middle East Countries Brings Opportunities for the Development of Production Capacity Cooperation

From a macroeconomic perspective, the major problem in the modernization of the Middle East is the strong dependence on foreign markets. A lot of countries have only a single type of resource: the oil resource is abundant, but other resources are relatively scarce and need to be imported from foreign countries. Take Egypt as an example, petroleum and natural gas, tourism, remittances and the Suez Canal are the four largest sources of foreign exchange earnings, but it lacks important industrial sectors that are capable of supporting the economy. The economic and social development of Arab oil producers is highly dependent on oil and natural gas; their industrial and economic structure is simple, with low level of economic diversification. For example, Saudi Arabia mainly relies on the oil industry—the oil industry

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accounts for about 75% of the country's total revenue, and accounts for 90% of the export income. In the context of economic globalization, the drawbacks of this model which relies on energy resources to promote economic and social development are becoming increasingly apparent; it is difficult for it to cope with the risks and challenges of the international market. In recent years, in order to adapt to the new situation of economic globalization, countries in the Middle East blindly followed the Western neo-liberal model, with one-sided emphasis on trade liberalization, financial liberalization, and privatization. They turned into excessive reliance on the service sector, and the situation of laggard industrial economic structure has not been fundamentally changed. As a result, many Middle East countries are still on the edges of the process of economic globalization.

Viewed from the political and economic reality, the Middle East upheavals breaking out in 2011 resulted in heavy economic losses. Egypt and other countries began their difficult economic and political reconstruction by taking a series of measures. At the same time, although wealthy due to petrodollars, Saudi Arabia and other countries escaped the scourge of upheavals, they are also trying to promote national economic structural adjustment as a response to the pressure of global economic downturn and the continuous doldrums of oil prices. Middle East countries have developed new medium and long-term development plan, focusing on promoting industrialization with the priority of the expansion of infrastructure and equipment manufacturing in high-tech industry. This provides a new historical opportunity for Chinese enterprises to "go out".

Egypt is a typical transition country in the Middle East, and its economy suffered a lot from the upheavals. After the ousting of the Muslim Brotherhood leader Mohamed Morsi, President al-Sisi

was well aware that the development of production and the improvement of people's livelihood are fundamental to hold on to power. The priority of the current Egyptian economy is employment; the Egyptian government needs to create good jobs for the people and at the same time, reduce the budget deficit, and maintain foreign exchange reserves. Only by this way can Egypt facilitate economic development. Therefore, besides the aid of more than \$20 billion from Saudi Arabia, Kuwait, and the United Arab Emirates, the government of Egypt also gained assistance from the International Monetary Fund and other international financial institutions through the reduction of subsidies, especially the fuel subsidy. The Suez Canal is Egypt's main source of foreign exchange earnings; in 2014 Egypt completed the dredging project of the new Suez Canal, which increased the annual income of the Suez Canal waterway from \$5.3 billion to \$13.4 billion. Egypt also developed the Suez Canal corridor plan, intending to build the area of 7.6 square kilometers along the coast into a world-class port and a logistics, processing and manufacturing hub with the construction of 5 port terminals and 3 industrial parks. It is expected to bring about \$100 billion additional revenue for Egypt (Yang, G., 2015: 169).

Saudi Arabia will continue to promote economic restructuring. To achieve economic diversification and reduce the dependence of the oil industry are its macroeconomic development strategic objectives. Economic city and industrial city are important means for Saudi Arabia to adjust the economic structure and to realize industrialization and diversification. Saudi Arabia will invest \$500 billion to build the King Abdullah economic city, the Jazan economic city, Prince Abdullah Azee Ben Mossad economic city, and knowledge economic city, among others. The knowledge economic city will become the core of Saudi Arabia's high-tech

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knowledge-based economy. As of 2015, Saudi Arabia has built 18 industrial cities, and plans to increase the number to 30 in the next 5 years. Former King Abdullah's goal was to turn the country into a strong industrial power in 2020, and to build a world-class plant in the four major industries: petrochemicals, aluminum, iron and steel industry and fertilizer (Yang, G., 2015: 178).

The United Arab Emirates is preparing to meet the "post oil era". In 2015 UAE president al-Khalifa announced the "highest policy on National Science and technology and innovation"; the United Arab Emirates will invest 300 billion dirhams (approximately \$82 billion), to support the development of knowledge economy and innovation (Economic and Commercial Counsellor's Office of the Embassy of the PRC in the UAE, 2015: November 25). The plan will include 100 initiatives, including investment areas, such as education, health, energy, transportation, space and water resources. The policy is an important decision the United Arab Emirates made to gradually get rid of the petroleum economy and realize the economic transformation.

Over the past decade, with the rapid development of the national economy, Turkey's political situation has been relatively stable; it has leapt to the world's seventeenth largest economy. At present, due to the weak global economic recovery, and the serious foreign capital flight, the Turkish economy is facing more and more difficulties, as well as the challenge of economic upgrade. To this end, Turkey has developed a grand plan for the 100th anniversary of the founding of the Republic in 2023. At that time, according to the plan, the total economic volume of Turkey would rank among the world's top ten, per capita national income would amount to \$25,000, foreign trade would reach \$1 trillion, employment would increase by 30 million, and the unemployment rate would fall to 5%; the country plans to give priority to the

development of energy, transportation, tourism and other industries, and to expand high-speed rail network with newly built railway of 11,000 kilometers, to construct two-way expressway of 15,000 km, and to own one of the ten biggest ports in the world.

A comprehensive agreement on Iran nuclear issue has been reached. It provides favorable conditions for the lifting of sanctions, and eases Iran's conflict with the United States and the West, and also shows an important historical opportunity to promote economic development and enhance its national strength. Iran's supreme leader Ali Khamenei announced the new development plan in Iran: in the next five years, the average economic growth target is set at 8%, and the required capital is up to \$1 trillion (Economic and Commercial Counsellor's Office of the Embassy of the PRC in Iran, 2015: July 6).

III. The Middle East Countries Actively Respond to China's Production Capacity Cooperation Initiative

China adheres to the principle of mutual benefits and win-win in production capacity cooperation with the Middle East countries. After 30 years of reform and opening up, China's industry has grown bigger and stronger. To accelerate the "going out" of Chinese equipment and the pace of promoting cooperation in production capacity is an important initiative for China's economy to improve its quality, efficiency, and achieve upgrading. Many countries in the Middle East are in the critical stage of industrialization. According to the national competitiveness index by United Nations Industrial Development Organization, Middle Eastern countries, especially Arab countries, are relatively weak in overall industrial competitiveness. The total value of their

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industrial output accounts for about 5% of the world; in contrast, China's Industrial added value and the export of manufactured goods account for 15.3% and 14.1% of the world's, respectively. Cooperation between the two sides has solid foundations and their advantages are complementary with a high degree of capability; to accelerate the development of production capacity cooperation will bring new historical opportunities for the development and stability of the Middle East. In August 2015, the China-Arab National Production Capacity Cooperation & Investment Promotion Seminar was held in Beijing. This was the first time the two sides held a conference with production cooperation as its main theme. Delegates agreed that the production capacity cooperation between China and Arab countries will fully combine productivity advantage of China with the resources, geographical advantages and market advantages of Arab countries, which conformed to the trend of world economic development (Zhong, S., 2015: August 25). Production capacity cooperation with China is receiving an increasingly positive response from the Middle East countries.

In December 2014, Egyptian President Sisi visited China. He said in his talks with President Xi Jinping and Prime Minister Li Keqiang that, Egypt would be willing to expand the friendly and mutually beneficial cooperation with China, especially cooperation in capacity, investment and financing and other fields. He welcomed Chinese enterprises to actively participate in the construction of large projects in Egypt. China and Egypt have reached an agreement on the construction of railway networks, solar power stations and other projects, signed a number of economic cooperation agreements, including electric power, new energy, civil aviation and other fields. Egypt also set up a government committee led by the deputy prime minister to deal

with Chinese investments and cooperation. In addition to the implementation of the Suez Canal Zone Development Plan, the Egyptian government is also exploiting the northwestern coast region which accounts for 10% of National territory area; they expect China to increase investment in Egypt.

In August 2015, the Sudanese Minister of Industry Abdullah took a special trip to China to attend the China-Arab National Production Capacity Cooperation & Investment Promotion Seminar. He said that the Sudanese government was developing economic reform plan for the 2015-2019; they looked forward to the cooperation between China and Sudan in the fields of agriculture, industry, and resources, and had already incorporated the cooperation of China into its five-year plan. In early 2015, Sudan also sent a delegation to China and agreed to transfer some of the capacity advantages of Hebei Province, China to the Red Sea Free Trade Zone under construction; they were willing to sign the relevant agreements with China.

At present, China and Turkey are working hard to make plans to carry out the production capacity cooperation more smoothly and effectively. In July 2015, President Xi Jinping proposed to Turkish President Erdogan, who was on a visit to China, that China and Turkey should promote the continuous development of bilateral relations through “a guiding mechanism, two key areas of cooperation, and three emerging areas”. “A guiding mechanism” means that China and Turkey will establish a cooperation mechanism led by a deputy prime minister to be in charge of comprehensive coordination and cooperation between the two countries in various fields; “two key areas of cooperation” refers to the decision that both sides strive to focus on two key areas of cooperation: high-speed rail and new energy”; “three emerging areas” is to further advance cooperation in three new

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areas: aerospace, finance, and investment (Jiang, W., 2015: August 7). President Erdogan agreed with the opinion of President Xi Jinping, and said Turkey was willing to make joint efforts with China to deepen cooperation in trade, investment, science and technology, infrastructure and other areas. In November 2015, when President Xi Jinping met with President Erdogan in the G20 Summit held in Antalya, Turkey, the two sides signed the "memorandum of understanding" between the governments to jointly promote the construction of "One Belt and One Road", which would provide important policy support for both sides to promote cooperation in various fields under the Belt and Road Initiative framework.

Currently, China and the Middle East countries can focus on the following areas in the production capacity cooperation: first, infrastructure. The market of national engineering contracting in the Middle East is huge, its engineering contracting market accounts for 19% of the world total, and the scale is up to \$4 trillion. At present the two sides are making efforts to collaborate in the field of high-speed rail, electricity, and port construction. Relevant Chinese enterprises wish to sign the Turkish East-West high-speed rail project contract as soon as possible, to seize the opportunity that a comprehensive agreement has been reached on the Iranian nuclear issue, accelerate the cooperation in Tehran-Isfahan high-speed rail project and other large projects, and further promote the construction of China-Iran industrial park (Zhao, J., 2015: October 14). The second is the equipment manufacturing in high-tech field. China has advanced aerospace technology, complete scientific research system as well as a complete set of industrial facilities. China supports an open space policy, and actively carries out various forms of international cooperation. Egypt and the United Arab Emirates have started

their satellite launching project, and the Arabia Communications Alliance is promoting satellite network. Turkey intends to launch 17 satellites into orbit. The newly established renewable energy projects in the Middle East generate electricity capacity of 37 million kilowatts, and Turkey actively builds the first nuclear power plant. From a global perspective, the Middle East is an important region with growing demands in nuclear power, space satellites, and new energy. There is great potential for cooperation between the two sides. In 2014, the CNPC marched into the upstream oil and gas market in the United Arab Emirates for the first time, and obtained 40% shares of the land and maritime cooperation zone of the Abu Dhabi national oil company. The Shandong electric power construction company and Saudi Arabia's international electricity and water group signed a \$700 million Phase II project of MGS (gas booster station) (Economic and Commercial Counsellor's Office of the Embassy of the PRC in Saudi Arabia, 2015: November 23). In December 2015, Harbin Electric Group and the Saudi international electricity and Water Group signed a strategic cooperation agreement. The two sides will jointly develop the electric power market in Europe, Asia, and Africa. Meanwhile, the two sides have agreed to invest in a joint venture to build the first coal-fired power plant of Middle East in Dubai, which was the first time Chinese companies marched into the electricity market in the Middle East by investment & financing and general contracting mode (*Harbin Daily*, 2015: December 2). At present, China and the Arab countries have reached a consensus in projects, such as the China-Arab technology transfer center, and the Training Centre for peaceful use of nuclear energy in Arab, clean energy training center in Arab, and the BeiDou Navigation Satellite System (BDS) landing in the Arab world, showing the sincere wish and a huge potential of the

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cooperation between the two sides. The third is labor intensive industry. According to the International Money Fund statistics, in 2014, the economic growth rate of Arab countries was about 3%, with an average unemployment rate of 13%, and youth unemployment rate was up to 29.8%. By 2020, the number of unemployed young people in the Arab world will reach 50 million. If a huge number of the unemployed people are not properly dealt with, it is likely to see political and social unrest. These countries are eager to promote economic development and solve the high level of unemployment. China has many production capacity advantages in labor-intensive industries, such as textile, and has the ability to help promote a number of projects in the short-term period and to produce quick results as soon as it lands in the Arab countries.

In order to support the production capacity cooperation between Chinese enterprises and the Middle East countries, and to play the supporting and guarantying role of capital financing in the production cooperation, China and the Middle East countries have carried out several financial cooperation with their best efforts. Ten Middle East countries, including Qatar, Oman, Kuwait, Saudi Arabia, Jordan, the United Arab Emirates, Iran, Turkey, Egypt and Israel joined the Asian Infrastructure investment bank, and showed strong interest in China's establishment of the Silk Road Fund. Following that, in 2012, China and Turkey reached a currency swap agreement of 10 billion RMB for a period of three years, in November 2014, China and Qatar signed a bilateral swap agreement of 35 billion RMB/20.8 billion Rials. For the convenience of Chinese enterprises to carry out business activities in the Middle East, the industrial and Commercial Bank of China opened branches in Dubai, Abu Dhabi, Doha, Kuwait, Riyadh and Istanbul. Moreover, it is worth mentioning that on December 14,

2015, Abu Dhabi crown prince Mohammed visited China; China and the United Arab Emirates announced that they would jointly set up a \$10 billion investment fund. On the same day, the People's Bank of China announced the expansion of the pilot area of the qualified foreign investment of RMB to the United Arab Emirates, with investment quota of 50 billion RMB, which is an important manifestation of deepening the cooperation in the financial field between the two sides, not only conducive to internationalization of the RMB, but also a contribution to the promotion of trade and investment facilitation between China and the Middle East countries.

IV. The Risks of Production Capacity Cooperation between China and the Middle East

To carry out production capacity cooperation in the Middle East, China must take all the possible risks into consideration. The first is the intricate geopolitical jumble, with continued unrest in the region. Middle East is an area where the most global hot issues are concentrated. Since the upheavals in Middle East, the old and new hot issues have occurred one after another, with ethnic, religious, and sectarian conflicts intertwined with each other, and the game of great powers has been intensified, and, as a result, the region has remained in constant turmoil. In 2015, with the Iranian nuclear issue resolved through a signed agreement, there were signs that the situation in the region would ease, but the pattern of regional unrest has not been changed. At national level, since Sisi was elected president of Egypt, the political situation has gradually stabilized, and the economy has also shown a resumption of growth, but domestic extremism is still active, so are the terrorist activities, and the economy's structural problems

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have not been fundamentally changed, so its prospect of development is still largely uncertain. Due to external intervention, the civil war in Syria continues, and the country is facing a risk of being split. There are two governments and two Councils in Libya. Although at present they have reached a settlement, the fight has never ceased; political reconstruction and economic reconstruction are not on the table in the foreseeable future. Saudi Arabia achieved smooth succession of the throne, but within the royal family, power struggle is still intense behind the scenes. Due to the adherence to the policies of no reduction in production and maintaining the market share of Saudi Arabia, oil prices continue to slump, resulting in large loss in petrodollar income. Coupled with the complexity of the peripheral geopolitics, Saudi Arabia might not be the oasis of peace in the Middle East for long. The international community is about to remove the sanctions against Iran and Iran will return to the international community, but there will be ten years in process to implement the comprehensive agreement on the Iranian nuclear issue; one can predict that there will be many complex and sensitive issues. These regional and national situations will bring a lot of political security risks to Chinese enterprises in their "going out". So we must strengthen the risk assessment and analysis on regions, especially on the countries, to reduce bad debts in the production capacity cooperation projects between China and relevant countries, reduce the possibility of unfinished or abandoned projects, and enhance the ability to protect their own interests in the political turmoil.

Second, extremist terrorist forces are active. In recent the last two years, the "Islamic State" terrorist forces have grown fast in Iraq and Syria; they attacked and occupied cities, slaughtered the innocent at will, and are hideously brutal. The area controlled by the "Islamic State" has become a place for the aggregation and

diffusion of global extremist and terrorist forces. They are not only active in Jordan, Lebanon, Egypt and other neighboring countries, but also have penetrated Europe, Africa and other places. In November 2015, the "Islamic State" launched a series of bombings in Paris, France and other places, the bombing of Russian aircraft, and the brutal killing of innocent Chinese citizens. The terrorist acts of the "Islamic State" have caused a strong condemnation and indignation of the international community; it has become the world's most serious challenge faced by the international community. At present, the international community is pushing the fight against the "Islamic State". But we should see that, the "Islamic State" is a direct result of the revival of extremist religious ideology, wrong policies of the United States and the West in the Middle East, sectarian conflict and imbalance in Iraq and the long civil war in Syria; if these four major sources of the problem are not properly solved, the "Islamic State" and its extremist terrorist forces will exist for a long time. Facing the new situation of international terrorism, China needs, on the one hand, to strengthen international cooperation in the fight against terrorism and, on the other hand, should increase investment, strengthen and improve antiterrorism operating mechanism and protection mechanisms of its overseas enterprises and working personnel. At the same time, Chinese overseas enterprises, institutions and personnel should strengthen their safety consciousness, so in critical situations, they can respond appropriately to ensure the safety of their lives and property.

Third, the challenge from technical standards in Europe and the United States. Middle East countries generally respect European, American and Japanese technical standards, while distrusting China's technology standards. The construction of Mecca light rail in Saudi Arabia by the China Railway

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Construction Corporation ended up with a huge loss, which served as a big lesson. The company took over the construction of 18.25 kilometers of Mecca light rail project in February 2009 through negotiation; the completion of the project was in September 2010, with total loss of 4.153 billion RMB. The huge losses were a complex reason, including the substantial increase in requirements of the owner compared to the requirements in the original contract, and serious delays in land acquisition and relocation which increased the project workload and cost significantly. There is a point worth noting: the China Railway Construction Corporation thought it should have design rights, purchasing power and the construction right of the project, but that was not the case, because the owner did not trust China's equipment and technology, the civil engineering followed the American standard, the system engineering followed European standard, and the most profitable and equipment, such as the whole train carriage and signal equipment, are from Europe, which undoubtedly greatly increased the project cost (Cai, Y., 2010: October 29). Seen from this, China's technical standards are essential for China to carry out international cooperation in capacity. After many years of operation, countries in the Middle East have understand better China's engineering and technology standards in the railway, electric power, communication, metro, ports and other fields, especially high-speed railway. Through the introduction, digestion, absorption, innovation and improvement of the foreign high-tech, China has become one of the few countries in the world that has a comprehensive master of the high-speed rail technology, and has accumulated rich experience in operation and management of high speed rail. Faced with competition and pressure, China should do more work in cost and benefit analysis, to create brand with safety, stability, and

efficiency, and at the same time, rely on major projects to promote Chinese technical standards.

The main body of international production capacity cooperation is the enterprise. We must adhere to the market operation, follow market and international rules, and give full play to the role of the market in the allocation of resources. The enterprise should be under the guidance of the government, to summarize cooperation experience from the previous project contracting and industrial docking cases between China and Middle East, to dock with the actual needs of Middle East national development plan, and explore new ideas and new modes of production cooperation under the new situation like, for example, changing the previous reliance on low cost, to increase China's direct investment in the Middle East, and to enhance China's regional industrial layout. Besides, it is also necessary to change the old way of focusing on construction while ignoring management, vigorously promote the integration mode of construction and operation, and broaden financing channels. As oil prices continue to slump, oil producing countries in the Middle East are facing reduction in revenues. China should take different forms and multiple channels to solve their financing problem, and push the production capacity cooperation between China and the Middle East countries to a new and higher level.

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