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China and the Middle East
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Thank you to the members of the Commission for the opportunity to testify today. It is an honor to participate in this hearing.

Just a brief word about why I am here. I am a partner at Latham & Watkins, a global law firm headquartered in the US. After eight years in London, I moved to Dubai in 2008 to help set up our firm's four Middle East offices—in Dubai, Abu Dhabi, Doha and Riyadh. After four years living and working in the Middle East, I moved to Hong Kong last year.

For the last three years, we, with the support of the Dubai International Financial Centre, have organized and presented an annual conference called "The New Silk Road," that has brought together government officials, economists, investors and others to examine trade and commerce between China and the Middle East. In 2010 and 2011, the conference was presented in Dubai and in 2012 it was presented in Beijing, Shanghai and Hong Kong.

Middle East as a Trade and Logistics Hub for China

The Middle East is an important trade, logistics and financial hub for China's increasing trade and commerce with Europe and Africa. Total Chinese trade with Europe was approximately $567.2 billion in 2011, making Europe China's largest trading partner, ahead of the US total of $446.7 billion.[1] Chinese trade with Africa totals $120 billion per year now.[2] There are over one million Chinese living in Africa now, up from 100,000 in less than a decade.[3]

The Middle East sits squarely on what we call "The New Silk Road"—the new version of the ancient roads over which caravans transported goods back and forth between China and Europe.

Many of the Middle East countries have been eager to support this new stream of commerce emanating from China. Dubai in particular stands out. In the last decade, it has built its Jebel Ali Port into the largest container port in the Middle East and the ninth largest in the world.[4] Interestingly, of the eight larger shipping ports, one is in Singapore, one in South Korea and six in China.

Dubai's port now exceeds by 63% the shipping volume of the largest port in the US—the Port of Los Angeles.[5] And—to give a sense of how much China produces and how important these new trade routes are to China—the aggregate shipping volume of the 14 Chinese ports on the list of top 50 ports is *eight times* the total volume of the four US ports on this list.[6]

In addition, Dubai has built Emirates Airline into the world's fourth largest airline by capacity—after only United, Delta and American—with capacity growing 20% in the last year.[7] Emirates has 20 flights—mostly on A-380s—to and from China each day, connecting Chinese passengers to the Emirates network of more than 120 cities. Although not as large, Qatar Airways, the state-owned flag carrier of Qatar, has followed Emirates Airline strategy of linking over 100 international destinations through Qatar, and Etihad Airways, the Abu Dhabi state-owned flag carrier, links 86 international destinations through its base in Abu Dhabi.

Dubai has also welcomed thousands of Chinese as permanent residents. Currently, Dubai has more than 200,000 Chinese residents, constituting about 10% of Dubai's population.[8] That compares to estimates of 9,000 American residents in Dubai.[9]

Although some of the Chinese may have emigrated as workers on projects run by the large state-owned construction companies, most are professionals working in the Chinese banks in Dubai or middle class owners and employees of small to medium businesses. The Consulate-General of the People's Republic of China in Dubai estimates there are some 3,500 Chinese-owned companies operating in the UAE, mainly in Dubai, Abu Dhabi and Sharjah.[10]

Trade and Commerce Between China and the Middle East

But the Middle East is more than a hub for the onward Chinese investment and itself is a major trading partner with China. The trade volume between China and the Arab world reached $195.9 billion in 2011, a 35 per cent increase from the previous year, according to China's Ministry of Commerce.[11] Experts expect that figure to top $300 billion in 2014.

It is no surprise that the Middle East's major exports to China are petroleum and natural gas.

What is more interesting is what comes back from China. One of the best ways to see this is to visit DragonMart in Dubai. DragonMart is the largest trading center for Chinese products outside of the mainland China.

DragonMart, which snakes for 1.2 kilometers, has 150,000 square meters which contain over 3,950 wholesale and retail shops. It is a gateway for Chinese products in the Middle East and North African markets, offering Chinese traders and manufacturers an efficient way of introducing and selling their goods into these sizeable markets. Chinese products sold include home appliances, stationery, office appliances, communication and acoustic equipment, lamps, household items, building materials, furniture, toys, machinery, garments, textiles, footwear and general merchandise.

DragonMart has been such a financial success that work has started on an even larger second DragonMart next door that will have 175,000 square meters of space.[12]

In addition to DragonMart, the Middle East is a gracious host to numerous trade fairs promoting Chinese goods and services. As one example, the annual China Homelife exhibition at the Dubai World Trade Centre features over 1,000 Chinese suppliers of textiles and garments.[13] As another example, the Chinese Commodities Fair, held every year in Sharjah, features Chinese agricultural products, techniques and equipment.[14]

As Chinese products become more complex and sophisticated, Chinese manufacturers are setting up sales and service operations throughout the Middle East to be able to provide maintenance and repair services. For example, Honghua Group, a leading global land drilling rig manufacturer, announced late last year the opening of its sales and maintenance service center in Dubai's Jebel Ali Free Trade Zone. The new service center will provide sales, maintenance, refurbishment, spare parts supply and storage, equipment rental and after-sales service in the Middle East, Africa and Europe. In addition, the new service center will be able to assemble 10 drilling rigs annually.[15]

One of the largest Chinese exports to the Middle East is telecoms equipment and services. Huawei has 3,800 employees in offices in 10 Middle East countries. Revenues from the Middle East totaled $2.0 billion in 2012, an increase of 18% from the previous year.[16] Huawei provides services and products to most of the region's leading telecoms carriers. This year, for instance, Huawei entered into an agreement with Etisalat, the leading UAE carrier, for global consultancy services, and partnered with Saudi-Arabia's second leading carrier, Mobily, to expand Mobily's 3G and 4G services throughout Saudi Arabia.[17]

Chinese Investment in Banking and Finance in the Middle East

With such a growing and vibrant Chinese business community comes the need for Chinese financial services, including the ability to convert and clear yuan into other currencies.

The four largest Chinese state-owned banks−ICBC, Bank of China, Agricultural Bank of China and, most recently, China Construction Bank[18]−now have presences in the Dubai International Financial Centre. Trade in the Chinese yuan by banks in Dubai has been increasing—ICBC said it conducted $2.1 billion of yuan transactions in the Middle East interbank money market in the first half of 2012, up 58 percent. A number of non-Chinese banks, including HSBC, Standard Chartered and Dubai-based Emirates NBD, now offer RMB accounts in the UAE.

As part of Premier Wen Jiabao's visit to the Middle East in January 2012, the Central Bank of China and the Central Bank of the UAE reached agreement on a currency swap. The deal. which exchanges 35 billion RMB ($5.54 billion) for 20 billion AED ($5.44 billion), was reached to promote bilateral trade and investment. However, this one time exchange was a stop-gap measure until full yuan convertibility can be established.

Currently, yuan clearing is conducted in Hong Kong and Taipei and will soon be conducted in Singapore. China recently named ICBC as the clearing bank for yuan business in Singapore.

Officials at the DIFC would like Dubai to become the next market outside China to provide yuan clearing. But any such arrangement for Dubai would depend on discussions and agreement between UAE and Chinese authorities.[19] Dubai's intention to become the Middle East center of offshore RMB trading received a boost in February 2013 when the chief executive of the Hong Kong Monetary Authority (HKMA), Norman Chan, said that Dubai could follow in Hong Kong's footsteps as trade flows between China and the region continue to grow.[20]

Chinese Investment in Non-Energy Infrastructure in the Middle East

To date, Chinese contractors have not won—or even bid for—the most technologically sophisticated and complex projects in the Middle East. In recent years, such projects have been won mostly by the South Korean and the Japanese contractors.

For example, one of the most sought after recent Middle East projects was the $20 billion contract to design and build the nuclear power plant that will be operated by the Emirates Nuclear Energy Corporation (ENEC) in Abu Dhabi. This will be the first nuclear power plant in the Arab world. After a 12-month bidding process, ENEC awarded the project in December 2009 to a South Korean consortium consisting of Korea Electric Power Corporation (Kepco), Hyundai Heavy Industries, Samsung Engineering and Construction and Doosan Heavy Industries and Construction. The decision surprised industry experts, who had expected that the project would be awarded to the American or French bidders.[21]

Other high profile Middle East projects have similarly been awarded to South Korean or Japanese contractors. For example, the contract to build the Burj Khalifa in Dubai—the world's tallest building—was awarded in 2004 to a consortium led by Samsung Engineering and Construction and Arabtec. In 2005, the contract to design and build the Dubai Metro—the first fully automated driverless metro network in the world—was awarded to a consortium made up of Japanese companies including Mitsubishi Heavy Industries, Mitsubishi Corporation, Obayashi Corporation and Kajima Corporation.

Notwithstanding their later arrival, Chinese contractors have developed a strong market share in infrastructure and transport—areas of expertise honed at home during the enormous Chinese infrastructure build-out over the last two decades. Chinese contractors are building approximately 45% (by value) of the infrastructure and transport projects run by the non-Middle East contactors included in region's top 25 contractors.[22] By contrast, US-based contractors have approximately 9% of such contracts.

Israel

Red Sea Land Bridge: When: Israeli Prime Minister Benjamin Netanyahu visited China on May 8-10, 2013, he reached agreement in principle with the Chinese on a railway line that could turn Israel into a land and sea bridge for Chinese exports to Europe. The plan is to build a 180 kilometer high-speed railway from Israel's southern port in Eilat on the Red Sea to its Mediterranean port in Haifa. From there, cargo can travel onwards to Europe. The route will be far faster than ships sailing through the Suez Canal to reach the Mediterranean. After it is built, ships arriving with goods from China will be able to off-load their containers in Eilat and by-pass the Suez Canal completely. The railway is expected to increase trade from China, India and other Asian countries through Israel, while also reducing Tel Aviv's dependence on a waterway controlled by Egypt. Construction is expected to take about five years to complete and will cost about $4 billion. [23]

Saudi Arabia

Haramain High-Speed Railway: The 450 kilometer Haramain high-speed rail link will connect the two holy cities of Mecca and Medina via Jeddah and the new King Abdulaziz International Airport. The line, which is now moving into its second phase of construction, is scheduled for completion in 2014. The $1.8 billion contract was awarded in February 2009 to a consortium including China's Railway Engineering.[24]

North-South Railway: The 2,400 kilometer North-South Railway is being developed by Saudi Railway Co. The $5.3 billion flagship project is on track with the start of passenger services scheduled for July 2014. It will link the country's northern mineral belt with Riyadh and the industrial city of Jubail. The rail link is due eventually to connect to neighboring countries as part of the GCC rail link. In September 2009, a consortium including China Civil Engineering Construction Corp (CCECC) was awarded a $720 million contract for the construction of a section of the North-South Railway.[25]

Mecca Monorail: The $1.7 billion 180 kilometer monorail project linking Mecca, Mina, Muzdalifah and Arafat was awarded in March 2011 to China Railway Company.[26]

Ras Al Zour Desalination and Power Plant: The $5.0 billion Ras Al Zour Desalination and Power Plant was awarded to a consortium that included China's Sepco III Electric Power Construction Corporation. The project is under construction and is expected to be completed in 2014.[27]

New Port in Saudi Arabia. On Saudi Arabia's east coast, Ras al-Khair Minerals Industrial City is being positioned as an export gateway for bauxite from mines in the north of Saudi Arabia. Ras al-Khair is being built as a hub for 80 industrial projects, including a $4 billion aluminum smelter. To support these plans, Saudi Arabia is building a three-berth port to handle cargo. The $600 million construction contract for the new port was awarded to China Harbour Engineering Company.[28]

Egypt

High Speed Railway. The Egyptian Ministry of Transport has suggested to Chinese officials and Chinese investors that they contribute to the establishment of a high-speed railway linking Cairo, Alexandria, Luxor, Hurghada and Aswan. During his recent visit to China with Egyptian President Mohamed Morsi, Minister of Transport El-Meteny made the case for the new railway to a group of executives from 200 of China's largest companies.[29]

Egypt-TEDA Investment. The Tianjin Economic and Technological Development Area, or TEDA, runs an economic zone in northern China and has established five other such zones in Africa. Egypt-TEDA Investment, a joint venture with the Egyptian government, runs an economic zone in the outskirts of Cairo, where Chinese and Egyptian firms can set up manufacturing and trading operations with the help of certain government concessions. TEDA intends to invest over $200 million in the Cairo zone, which is popular because of its proximity to the Suez Canal and because of the trade agreements under the Suez Economic and Trade Cooperation zone. With about 30 textile, petroleum and automobile companies up and running, TEDA executives say they will need up to quadruple the size of the project in the coming years.[30]

Qatar

New Doha Port: The New Doha Port project is being constructed at an estimated cost of $8 billion. The port will be constructed in three phases; the initial phase is due for completion in 2014 and the final stage in 2025. It will be located 5 kilometers offshore, with a bridge connecting it to the mainland. The port will have five cargo terminals and four container terminals. In January 2011, China Harbour Engineering Company (CHEC) started construction on foundations and a breakwater. The project, valued at around $880 million, entails building a container wharf, general cargo wharf, naval forces wharf and breakwater at the port. The project will take around four years to complete.[31]

Iraq

Gas-Fired Power Plant at Al-Najibiya: The $205 million Gas-Fired Power Plant at Al-Najibiya in Basra will generate 500 megawatts. It was awarded in April 2011 to the China National Machinery and Equipment Import & Export and one local contractor. It is under construction and is expected to be completed in September 2011.[32]

Samawa Cement Factory: The $250 million Samawa cement factory was awarded to the China National Building Material Company in September 2010 and the project was completed in 2012.[33]

Libya

Railway Projects: Chinese state-controlled company China Railways Construction (CRCC) has taken a strong investment position in Libya's railway sector. In January 2009, it signed a $805 million contract with the Libyan railway authority to construct a 172 kilometer rail line and in 2008 work started on a $1.7 billion project to connect the town of Sirte with Tripoli, a $2.6 billion project to connect Khums to Sirte and a $1.3 billion project to connect Sabha to Misrata. These projects have been delayed by the Arab Spring violence in Libya and the overall status of these projects is not clear at this time.[34]

Iran

East-West Railway: The Chinese government has made an offer to build a new freight rail line in Iran aimed at allowing continuous rail transport of goods from China, through the Middle East, to Europe. Iran's minister responsible for transport is reported to have invited bids to construct the line.[35]

Kuwait

Boubyan Port: The contract for phase 1 of the construction of the $1.14 billion Boubyan Port project was awarded in 2010 to a consortium that included China Harbour Engineering Company.[36]

College of Engineering & Petroleum, Kuwait University. The $505 million contract to build the new College of Engineering & Petroleum, Kuwait University, was awarded in 2011 to China Metallurgical Construction Corporation and another local contractor. The project is expected to be completed in 2014.

Chinese Investment in Medical Devices and Pharmaceuticals

Acquisition of Alma Lasers Ltd. On May 28, 2013, Shanghai Fosun Pharmaceutical (Group) Co Ltd, the listed Chinese pharmaceutical and medical equipment manufacturer, via its subsidiary Sisram Medical Ltd, acquired 95.6% of the shares of Alma Lasers Ltd, an Israel based developer, manufacturer and marketer of medical laser equipment, for $221.1 million from independent third parties. Concurrently, Ample Up Ltd, a wholly-owned subsidiary or Fosun Pharmaceutical, acquired 9.5 million shares in Chindex Medical Ltd, which holds a 100% stake in Sisram Medical Ltd. As a result, Ample's shareholding in Chindex Medical increased to 70%. In addition, Pramerica-Fosun Fund contributed $50 million into Sisram Medical and owns a 33.80% stake in the company.[37]

Acquisition of Makhteshim Agan. In October 2011, state-owned China National Chemical Corp (ChemChina) acquired 60% of the shares of Makhteshim Agan (MA) from its parent Koor Industries Ltd for $1.43 billion. Makhteshim Agan is a pharmaceuticals, agro-chemicals and food additives manufacturer.[38]

Conclusion

The Middle East is vast and complex. Large state-owned Chinese corporations and small to medium-sized privately-owned Chinese companies have entered into a broad array of projects and have made a broad array of investments and acquisitions across the Middle East. But these seem to be early days. In spite of the substantial investments China has made, Chinese contractors, with their focus on roads and railways, in important ways lag behind the more technologically-advanced clean fuels, petrochemicals and nuclear generation projects being run by the South Korean and Japanese contractors. But it is only a matter of time before the fast-growing and cutting-edge technology companies maturing now in China begin to look outward towards the opportunities in the Middle East and beyond.

Ben Simpfendorfer, the founder of New Silk Road Associates, and one of the China experts we have had speak at our New Silk Road conferences, maintains that Chinese strategy in the Middle East to date has been primarily economic rather than political.[39] That would seem to be borne out by the fact that China invests in both Israel and in Palestine, and in both Saudi Arabia and Iran. To the extent that Chinese has a political strategy in the Middle East, it appears to be focused first and foremost upon keeping the Middle East countries open as a logistical and financial hub to permit the continued flow of Chinese products to, and Chinese investment in, the Middle East, Europe and Africa.

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