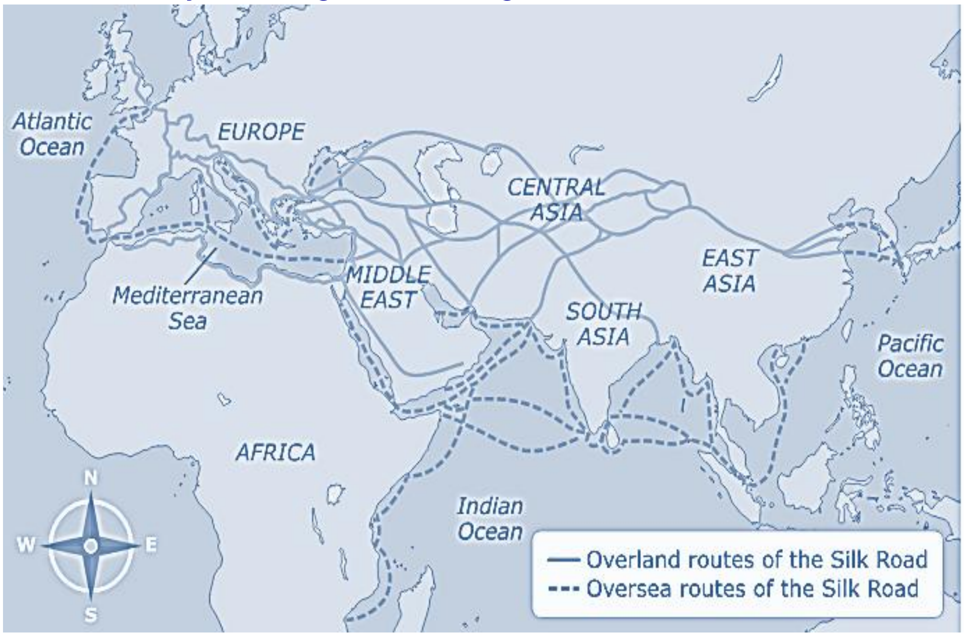
GrowStronger.com

Market Insights & Strategy
Global Markets

China & Arabia
'The Return of the Silk Road'

The term 'Silk Road' or 'Sidenstrasse' was coined by the respected German geographer, Baron Ferdinand Freiherr von Richthofen in 1877, but the ancient road itself consisted of a complex web of routes spread over both land and sea which saw the transfer not just of silk, but all sorts of goods including leather, spices, paper, tea, frankincense, porcelain and precious stones, as well greatly assisting in the exchange of technological, cultural and religious ideas between East and West more than 2000 years ago. The importance of this 'road' cannot be underestimated; it played a significant part in the development of some of the world's great civilizations and provided a foundation for the creation of today's modern world. Now in the 21st century China is actively restoring and upgrading these routes within its 'one-belt-one-road' initiative, a decision which is already having a profound economic and geopolitical impact across the globe. In this paper we focus primarily on China's ancient and modern links with the Middle East and discuss the potential outcome the resumption of this mega-project could have on the region and beyond.

Major trading routes along the ancient Silk Road



Source: IXL

More than just a road

Most historians agree that the 'official' formation of the land portion of the Silk Road took place around 139 BC when China was effectively unified and controlled by the Han dynasty. The word 'road' is something of a misnomer as goods were mostly transported by caravan across a series of rough paths and mountain trails which lay between the cities of Changan and Constantinople and snaked through Almaty, Kashgar, Karakoram, Persia, Palmyra and Mesopotamia amongst other trading hubs. From the 1st century there was already a sea route linking North Africa and India, but it was only in the 9th century that the movement of goods by ship, especially those run by Arab traders, began to supersede the slower and less efficient land based network. The primary maritime route at that time began in Canton, passed through the Spice Islands and travelled via the Indus valley (India & Pakistan), Ceylon and Arabia towards Alexandria in Egypt, for onward land and sea transfer to major cities scattered along the Northern Mediterranean coast.

7th August 2018

Glenn Wepener
Exec. Director & Geopolitical Analyst

Please click here to view our recent publications on MENA and Global Markets

Early Links with the Arab World

It's difficult to pinpoint an exact date or era when interaction between the Chinese and Arab peoples first began, but a study of early Chinese trade by the American historian Ivor Donnelly, highlights how far back interaction between the Arabs and the Chinese could extend. For example, some of the ancient vessels used to traverse the upper Yangtze River bear a striking resemblance to the barges used on the Nile River around 1600BC, and during the 'Han period' Chinese sailors apparently painted the figure of a water bird on the front of their boats, a custom similarly undertaken by the Egyptians. Meanwhile, a 1990s discovery of strands of Chinese silk in the hair of an Egyptian mummy dating back to 1000 BC further suggests contact probably occurred before the 'Silk Road' became a regular trade route. Another albeit much later link, was outlined in the writings of the Arab cartographer Muhammad al Idrisi who wrote in 1156AD, "*Muskat, the capital of Oman, is visited every year by great numbers of merchant ships, and is much frequented annually by vessels from 'Sin'* (China)."

In the Kingdom of Bahrain, visitors to the excellent 'Qal'at al Bahrain' museum situated on the site of an ancient port and fortress will find exhibits concerning the renowned Dilmun civilization (which once ruled the Arabian Gulf trade routes) as well as numerous examples of goods that were traded or transported via this island nation, including Indian pottery, Greek coins and Chinese porcelain. The fact that this particular site was occupied by various powers throughout the centuries such as the Kassites, Greeks, Ottomans and Portuguese underscores its strategic importance along the 'Silk Road.' Meanwhile archeologists excavating a site on the UAE's Sir Bani Yas Island in 2017 uncovered fragments of large jars dating back 4,000 years, as well as bronze tools and a Dilmun seal which likely indicates that this area was also actively involved in the maritime trade. Earlier this year, a joint Saudi-Chinese team began excavating the now abandoned port of Al Serrian, which lies on the Red Sea in Saudi Arabia and is believed to be one of the ancient gateways for Muslims making their pilgrimage to Mecca as well as a once busy trading hub. Amongst the relics found at the site was porcelain dating back to two Chinese dynasties, the Song period (960 -1729) and the Yuan period (1271 – 1368).

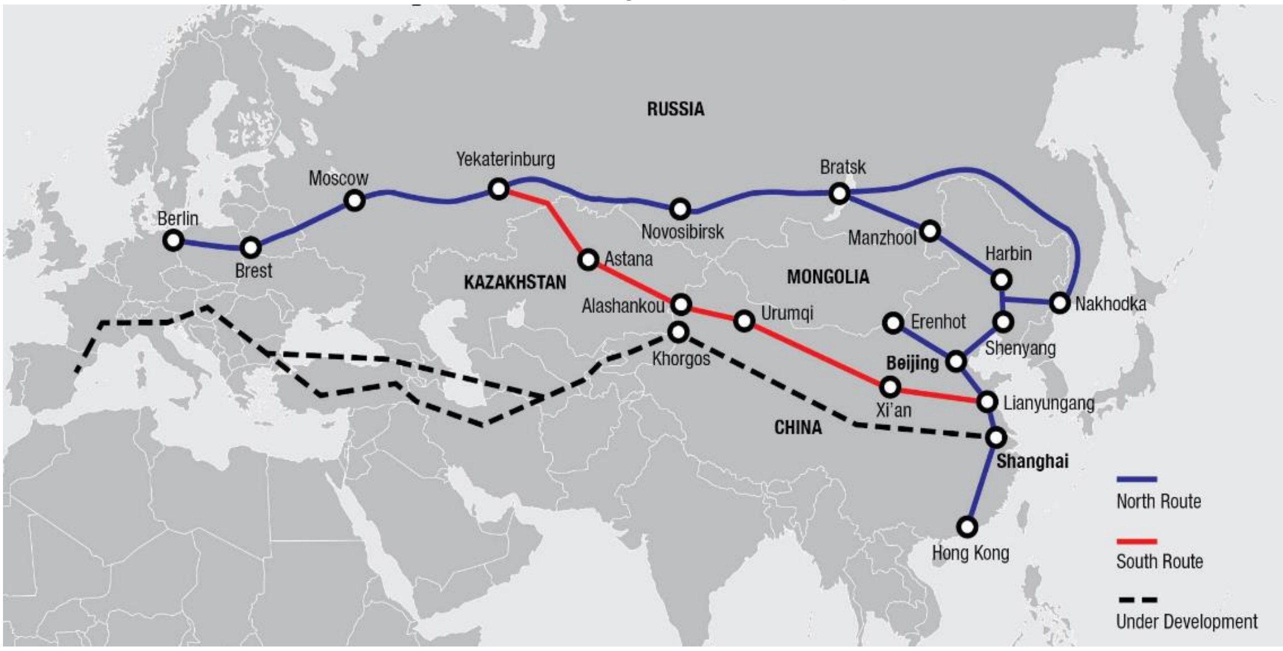
China's New Ambition - OBOR

Five years ago the People's Republic of China officially unveiled its 'One Belt – One Road' initiative, an enormously complex and far reaching trade and infrastructure project that the Chinese government claims is designed to promote closer commercial and political interaction between Asia, Africa and Europe, whilst also acknowledging the historic and physical similarity between this strategy and the famous trade routes of the ancient 'Silk Road.' 'One Belt' refers to land based economic interconnection whilst 'One Road' refers to the 21st century maritime routes.

The OBOR concept involves the construction of a communication and transportation grid consisting of roads, railways, ports, power plants and pipelines that will eventually involve at least 70 countries and encompass more than 60% of the world's population as well as over a third of its GDP. The funding for this megaproject comes primarily from soft loans provided by many of the state-owned Chinese banks, such as the Export-Import Bank of China, as well as the relevant companies involved and in some cases via direct government grants. While the scale of this plan is unprecedented, it is in some ways comparable to the 5 year US led 'Marshall Plan' that helped rebuild Western Europe following the end of World War Two. Of course OBOR is much grander and thus will obviously take much longer, but the facts on the ground already highlight the substantial progress achieved so far.

For example there are now 40 railway lines transporting goods between China and Europe with an average travel time of between 12-16 days. The world's largest inland port at Duisburg which lies at the junction of the Ruhr and Rhine rivers reportedly receives 30 'block trains' per week all loaded with Chinese goods, these carriages then make the return journey to China carrying luxury goods including clothing, vehicles, wine and olive oil from Italy, Germany, France etc. (Block trains are around 600 metres long and able to transport as many as 40 containers). The slight difference between Chinese, Russian and European rail gauges is no longer a time hindrance to this important transport link either, because infrastructure upgrades at key border points included the installation of huge cranes which lift the containers from one railway gauge to the next in a process that can apparently take less than one hour to complete.

China's Railway 'Belt' To Europe



Source: 'Week in China'

The modern maritime 'road' is even more important and is already reshaping global trade as China either purchases stakes in existing ports or provides substantial financial and engineering assistance in the construction of new ports and their related infrastructure facilities across Asia and beyond. One example of this is, the Duqm project in Oman, where China will eventually have invested over US$10 bio to create not just a major port, but a nearby "special economic zone" which will support various activities including vehicle assembly plants, manufacturing, hospitals, schools, offices and tourist attractions. In Pakistan meanwhile, work is underway to build a port at Gwadar, which lies on the coast of the country's largest province, and that a recent CSIS report suggests will be the gateway for a proposed 'China-Pakistan Economic Corridor.' This will eventually link-up with the Chinese city of Kashgar (close to the borders of Afghanistan, Kyrgyzstan and Tajikistan), which is over 2,000 years old and was one of the original main trading posts along the ancient 'Silk Road.'

Bumps along the way

Of course such a wide-ranging project carries with it not just great economic promise, but also sizeable risks both financial and political. A case in point is Myanmar's recent decision to scale back plans for the construction of a Chinese-backed port on the back of excessive debt fears, especially after a similar project in Sri Lanka reportedly ran into trouble. But the ratcheting up of threats by the Trump administration to apply a 25% tariff on US$ 200 bio worth of Chinese exports to the US, and counter moves by Beijing, is a much larger potential bump in the road as a full-blown trade war between the world's two largest economies could severely dampen global growth and disrupt supply chains.

The avoidance of taking on too much debt in a rush to join this mega-expansion plan is certainly something all countries involved along the OBOR network should bear in mind, especially those with relatively small economies. But let's not blow this particular issue out of proportion, the details surrounding the financial difficulties experienced by Sri Lanka's Hambantota port for example (which eventually led to majority control of the facility being handed over to the China Harbour Engineering Company via a PPP agreement) are complex. The agreement with CHEC reportedly includes an option for the Sri Lankan government to reclaim a majority stake in terminal at a later date, and does not appear to be strategic infrastructure grab as some media outlets have suggested it may be.

Meanwhile despite the recent increase in rhetoric, we still feel that a serious and widespread trade conflict will be averted, and that Washington and Beijing will come to an understanding on tariffs in the end.

However attempts by the US to introduce import penalties, not just on China but on other states too, could incentivize some countries, especially those connected in some way to this new silk road network, to switch their trade allegiances more heavily towards China in the future. This, in turn, could result in the establishment of more free trade agreements between these markets (including the Arabian Gulf states) and China. The OBOR project, or 'Belt–Road Initiative' (BRI) as it's now more commonly referred to, is reshuffling the cards in the global trade game. US soya bean farmers, who until now relied on China as their biggest and most lucrative export market, for example, may soon be usurped by new suppliers in Argentina, Brazil, Kazakhstan, Paraguay, Russia and the Ukraine, as Beijing looks for ways to respond to the US penalties including reciprocal targeted tariffs and allowing the Yuan to depreciate somewhat. Soya beans represent a key battle ground in this current trade dispute as it was the US agricultural sector's biggest export to China last year and is valued at US$12 bio per annum. Conversely, China's livestock feed industry relies heavily on its 100 mio ton consumption of these beans each year (about 60% of the global soybean market).

Looking further out the US is clearly also concerned over the possible threat that a new Silk Road led by China poses to its long-standing global influence, especially in Asia. Former President Barack Obama's 'Pivot to Asia' policy and interest in joining the 'Trans-Pacific Partnership Agreement' was a reaction to this fear, and although his successor decided to quit the TPP soon after he entered office, suggestions are that the White House may be considering rejoining it. Added to this, the US Defence Secretary, James Mattis, warned late last year that, "No one nation should put itself into a position of dictating BRI," while just last month Australia, Japan and the US announced a trilateral agreement to invest in infrastructure projects within the Indo-Pacific region. India too has until now now given a relatively lukewarm response to the OBOR project, and relations between Delhi and Beijing became severely strained following a dispute over the border with Bhutan last year. Things have improved however, after President Xi and Prime Minister Modi held face-to-face meetings in April and June this year in an attempt to resolve the issue and improve bilateral ties.

The Arabian Gulf Connection

The value of commercial activity between the China and the GCC jumped from just US$9.8 bio in 2000 to reach US$175 bio in 2014 according to the IMF. This rapid growth in bilateral trade flows has continued unabated since then, with the Gulf now China's largest source of oil and the second largest provider of its gas needs. China is also projected to become the GCC's largest export market within the next 2 years. But it's worth noting that this is not just a one-way transaction; by 2020 GCC imports from China are expected to double in value to around US$135 bio and the Gulf's tourism market is beginning to attract a greater number of affluent Chinese visitors, with a recent Colliers International report forecasting the total number of such arrivals to reach 2.5 mio within the next 3 years.

Political relations between Beijing and the GCC have also deepened and this was highlighted most recently by an official 3-day visit to the United Arab Emirates by President Xi Jinping, the first by a Chinese leader to the Emirates in almost 30 years. The UAE is home to the world's busiest port outside of Asia and thus an extremely important link in the global trade network. It is also China's second largest trading partner and its largest export/re-export market within the MENA region, while 200,000 Chinese citizens live and work here and more than 4,000 Chinese firms already have operating licenses in the country. The 'BRI' was a key discussion point during Xi's visit and resulted in a pledge by both governments to cooperate even closer together on this project. Another important announcement was the upgrade in UAE/China relations to a "Comprehensive Strategic Partnership," the first such high-level diplomatic status established between Beijing and one of the Arabian Gulf countries.

In this regard, Xi was quoted as saying that the UAE and China are "Strategic partners who truly trust each other" and will work together on regional and international issues. Numerous other agreements and MOUs were signed, covering a range of areas such as agriculture, e-commerce, finance, military cooperation, tourism, manufacturing and energy. These include; a contract worth US$1.6 bio between ADNOC and the China National Petroleum Corporation, (which follows the latter's US$1.17 bio purchase of two stakes in Abu Dhabi's offshore fields in March this year), a partnership and investment agreement between DEWA and China's Silk Road Fund to create the world's largest solar energy plant, and an agreement by DP World and the Zheijiang China Commodities City Group to construct a 3 sq.km 'Traders Market' within the Jebel Ali Free Zone.

Saudi Arabia's diversification program has also attracted keen interest from Chinese companies and investors, to the extent that there was even talk doing the rounds in October last year that China had offered to buy a direct stake of 5% in Saudi Aramco. Earlier this month China's Foreign Minister, Wang Yi, explicitly called for closer cooperation between his country's 'BRI' strategy and the Kingdom's ambitious 'Vision 2030' plan. His comments follow a similar statement made by President Xi last year during a visit to Beijing by King Salman, which in turn led to commercial agreements valued at US$65 bio being concluded between the two countries.

Conclusion

China's keen interest in establishing stronger links with the modern Arab world was probably first highlighted by the creation of the 'China-Arab Cooperation Forum', which was setup soon after China's former President Hu Jintao visited the headquarters of the Arab League in 2004. Then in 2016 came the release of China's 'Arab Policy Paper' that you can access here and which is a particularly interesting development, as it marked the first time China had laid out in public its official policy towards Arab countries. This further indicates a growing recognition by Beijing of the importance of the Middle East and the GCC in particular, as China works to consolidate and expand the 21st century's 'Silk Road' network. So, while it's still difficult to predict the final outcome of this mega project, it will undoubtedly continue apace and is already changing the world's previous and long-standing trade and geopolitical environment. The Arabian Gulf region with its strategic location, large energy resources and young population has a great opportunity to leverage on this change.

Glenn Wepener
Executive Director
Market Insights & Strategy
FAB Global Markets
Email: Marketinsights&strategy@bankfab.com
Tel: +971 2 6110 127
Reuters dealing codes: FABU / FABA

Please click HERE to view our recent publications on MENA and Global Markets