

# Geopolitics of the South China Sea

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**Powerful Thinking**  
for the global energy industry

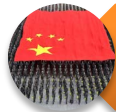
## Is the South China Sea “The Future of Conflict”?

- “Just as German soil constituted the military front line of the Cold War, the waters of the South China Sea may constitute the military front line of the coming decades...It is through sea power that China will psychologically erase two centuries of foreign transgressions on its territory, forcing every country around it to react.”
  - Robert Kaplan, “The South China Sea is the Future of Conflict,” Foreign Policy, Sept/Oct. 2011

# Geopolitical Challenge for China, ASEAN, US

Overlap of political, economic, energy issues

- The South China Sea dispute is at the heart of the political challenges of the coming decades in Asia:



China's military and economic rise



The future of US power in Asia Pacific and US-Japan ties



The role of ASEAN



Growth of naval power in the region



Competition for resources and energy



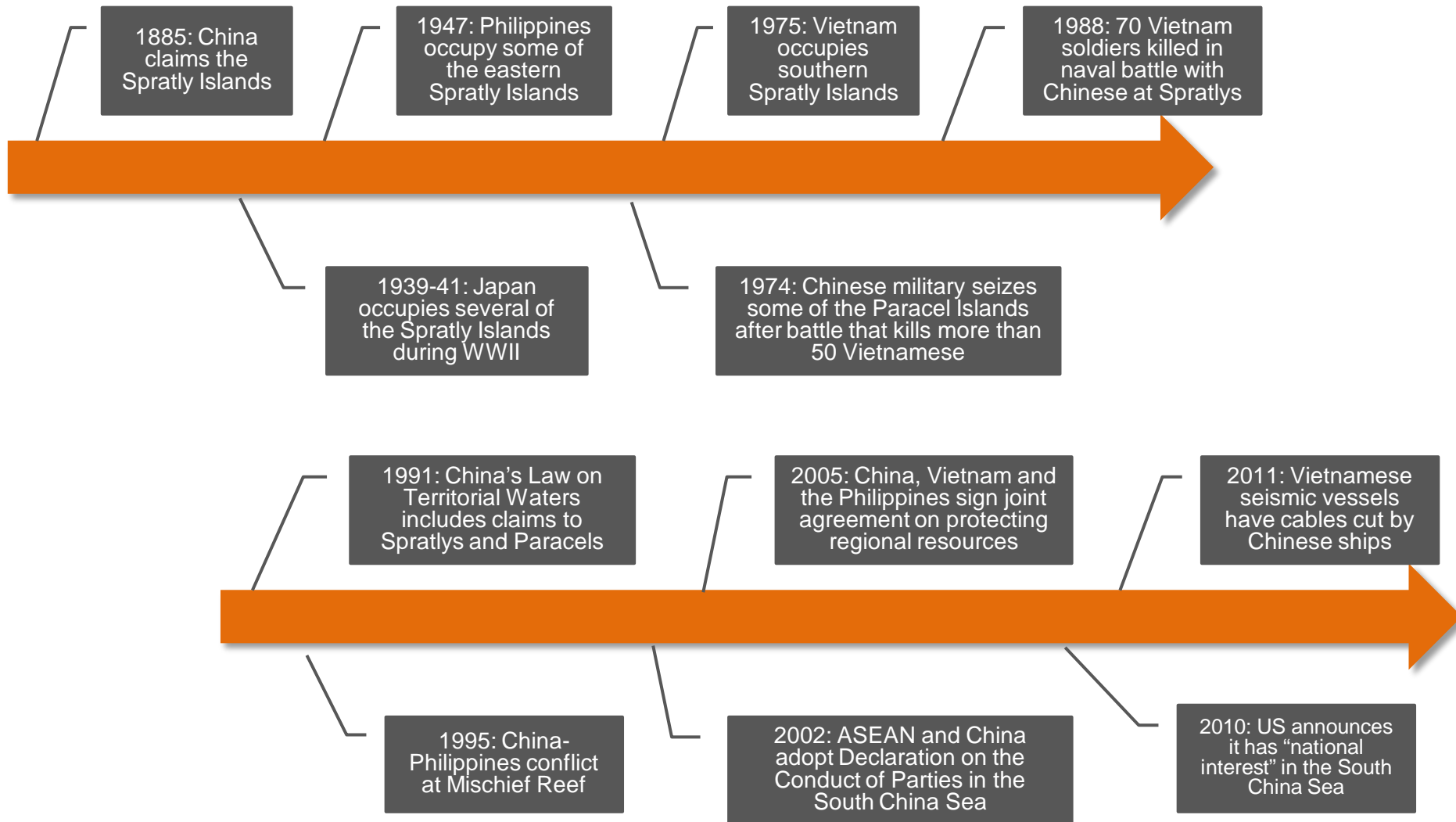
Maritime and trade security

## The Stakes

Vital shipping and energy transport lane

- The South China Sea is one of the world’s most important shipping waterways:
  - Over 50,000 vessel movements in 2010
  - More than 20,000 container ships
  - Ports on the South China Sea handled nearly 660 million tons of cargo
- Energy trade and transport:
  - Nearly 17 million b/d in oil transited the Straits of Malacca in 2010—nearly seven times the volume of Suez Canal shipments (2 million b/d)
  - Seventeen times the daily volume shipped through the Panama Canal (800,000 b/d)
  - Two-thirds of global LNG shipping transits the South China Sea
- 500 million people live within 100 miles of the South China Sea coast and depend upon access for trade, jobs and food

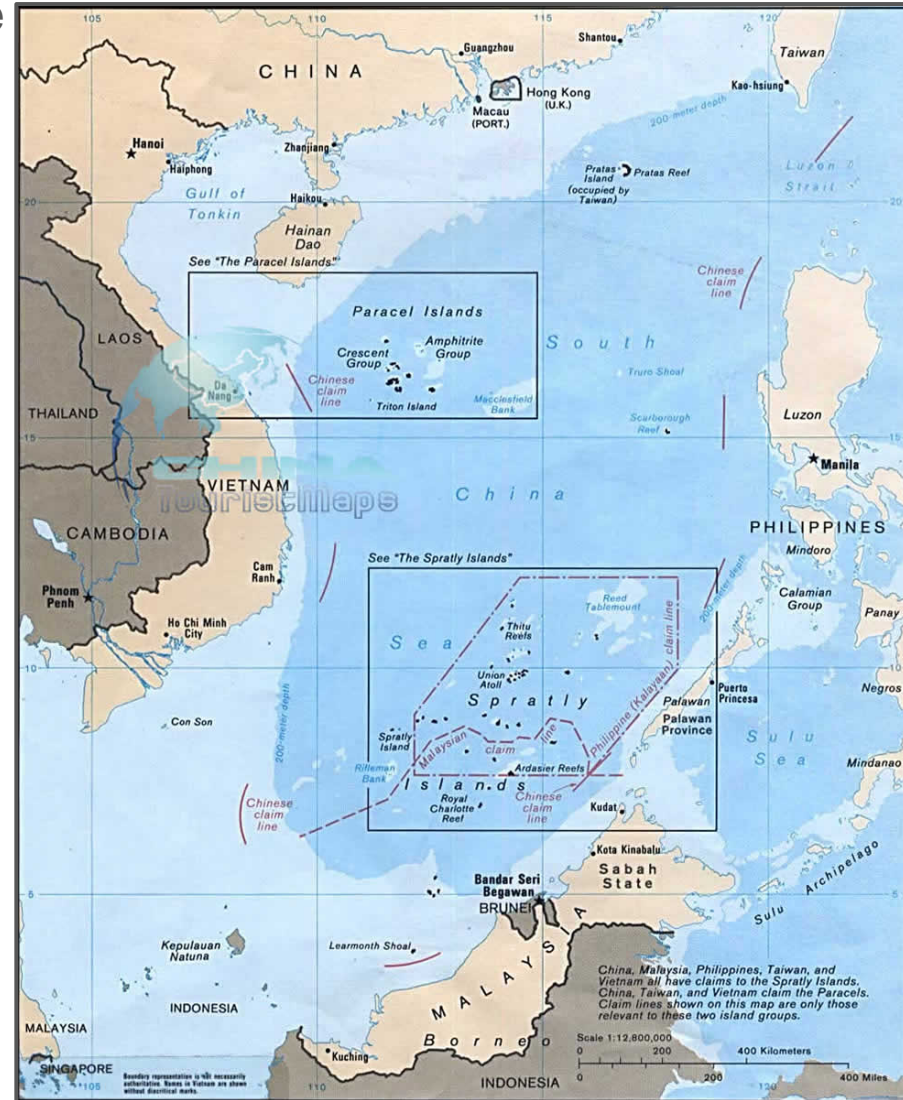
## Timeline of South China Sea Developments



# Territorial Claims in the South China Sea

Six countries with a direct stake

- China, Vietnam, The Philippines, Malaysia, Taiwan and Brunei all have territorial claims on the South China Sea waters
- Oil and gas resources are only one factor
- Areas of concern:
  - **China:** Control of sea lanes near Taiwan and Japan
  - **Taiwan:** Preventing China from controlling maritime space around its borders
  - **Vietnam:** Freedom of navigation, access to sea lanes, access to resources
  - **Malaysia:** Access to sea lanes; key to geostrategic significance
  - **The Philippines:** Hydrocarbon resources
  - **Brunei:** Hydrocarbon resources





## Chinese Claims and International Norms

### Claims infringe on EEZs of neighboring countries

- The Spratlys and Paracels are too small and uninhabited to be considered “islands” according to accepted norms
- In order to establish recognized authority over contested land, countries usually need to demonstrate **sovereignty** or **jurisdiction** or **control**
- **Sovereignty:** that there is “geographic dependence between the sea and the land,” that the land formations are close enough together to allow for a sovereign form of government, and that there are economic interests held by the coastal state
- **Jurisdiction:** authority over water space as established by continental shelf or exclusive economic zones (EEZ) that extend up to 200 nautical miles from shorelines



- **Control:** physical possession of islands, including habitation or troop presence – hence the scramble to establish bases on the “rocks” in the Spratlys
- China’s claims, on the basis that these are its “historical waters,” do not seem to measure up to international norms for all of the above
- All of the other neighboring countries also claim EEZ rights according to the UN Convention on the Law of the Seas (UNCLOS), which China has signed and ratified

# Control of Spratly and Paracel Islands

## Creating facts on the ground

- Given the ambiguities of international law over the Spratly and Paracel islands, countries in the region have occupied various islets, reefs, rocks and outcrops over the decades
- China, Vietnam and the Philippines have built what appear to be military installations on several of the larger islands
- All of the neighboring countries have staked some claim on the area—either through direct occupation of land or through appeals to the UN for economic rights
- Vietnamese and Malaysian claims submitted to the UN clearly conflict with China’s claims

**Islets/Features Controlled in South China Sea**

	Spratly Islands	Paracel Islands
<b>China</b>	7	Entire group
<b>Vietnam</b>	21	
<b>Philippines</b>	9	
<b>Malaysia</b>	5	
<b>Brunei</b>	None; EEZ claim only	
<b>Taiwan</b>	1	



## Land Grab

Rocks and outcroppings now home to troop installations



*Chinese military structure on one of the Spratly Islands*

## Impact on Oil and Gas Licensing

Regional tensions hindering E&P activity

- E&P activity in contested zones has been subject to flare-ups, with China protesting loudly against perceived encroachments on its territory
  - Wikileaks has released US cables showing Chinese pressure dating back to 2006 on ExxonMobil, Chevron, BP and PETRONAS over investments in Vietnam, with the implicit threat of blocking them from future opportunities in China
  - In 2007, BP withdrew from two offshore blocks (05-02 and 05-03) in Vietnam under Chinese pressure
  - In 2011, an ONGC-PetroVietnam JV for exploration offshore Vietnam (Blocks 127 and 128) was criticized by China for including blocks in contested areas
  - In late 2011, ExxonMobil's discovery in Block 118 in Vietnam renewed Chinese criticism in the official media

# China-ASEAN Dialogue Not Likely to Produce Solution

## The role of ASEAN

- The Association of South East Asian Nations (ASEAN) has developed a framework for settling the South China Sea dispute
- The 1992 Declaration on the Conduct of Parties in the South China Sea (renewed last year) emphasizes a peaceful, gradual approach to resolving territorial conflicts—but it is notably lacking in specifics in terms of claims and rights
  - Encourages regular meetings between China and ASEAN countries
  - Promotes cooperation in area like marine scientific research, environmental protection, maritime safety, and strengthen cooperation on military exercises
- The Declaration of Conduct is only an agreement to settle the matter by peaceful means, not a roadmap for solving the problems

### Ineffectiveness

- ASEAN generally focused on trade and economic policy-making, not issues of sovereignty
- Bilateral economic ties with China outweigh desire to settle maritime boundaries

### Internal Divisions

- No agreement among ASEAN members on marine boundaries
- No unified bargaining stance with China

# The US “Pivot” Toward Asia: Spin or Reality?

## Change in strategic focus for Obama administration

- Obama promised in the 2008 election to become America’s first “Asian president,” with the ship of state slowly turning from the Middle East toward Asian affairs.
- Economic problems at home and Middle East entanglements meant that this was never a realistic goal.
- The rhetoric was renewed last fall by troop drawdowns in Iraq and Afghanistan, with Hillary Clinton trumpeting a “pivot” toward Asia.
- Rather than a short-term process, this is the beginning of a long-term evolution.



Asian military budget upheld, despite \$500 billion in Pentagon cuts



Frequent visits to ASEAN, APEC events and bilateral meetings



Emphasis on strategic shift away from the Middle East with troop re-deployments



Pragmatic relations with China over currency and trade issues, despite Congress

## US Probably Unable to Act as Arbiter

Secondary issue for both sides

- The Obama Administration has called the South China Sea an area of “national interest,” but there is limited will to force countries to the negotiating table.
- As Obama and Clinton have stated, the first priority of the US in the South China Sea is simply to ensure trade security and freedom of navigation.
- In the host of bilateral US-China issues – trade, currency valuation, Chinese-held debt, regional security, Iran policy – the South China sea dispute is a fairly low priority.
- US efforts to push a resolution would irritate the Chinese while producing little benefit.
- For China, allowing the US to play a role in this dispute would set a bad precedent – and encourage the notion that other “Chinese internal matters” like Taiwan and Tibet policy should also involve the US.

### Not High on the Agenda



**China is far more likely to negotiate with ASEAN without strong US involvement—but strongly prefers a bilateral approach**

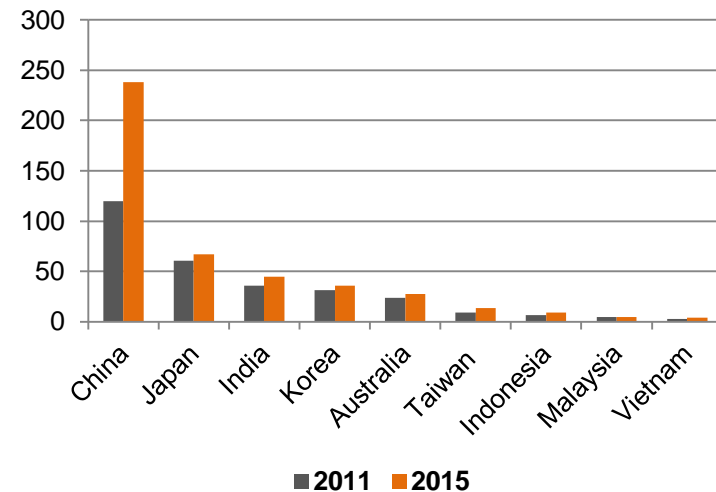


# No Chinese Challenge to the Status Quo

## China not seeking radical change

- For all of the occasional flare-ups over licensing and fishing rights, China – like the US – is essentially pursuing a status quo policy:
  - No desire to disrupt trade or shipping
  - Emphasis on stronger economic integration with Southeast Asia
  - Gradual growth in Chinese naval power
  - Ensuring security in the region
- China is a significant “free-rider” from the US-Japan strategic alliance in the Pacific: it benefits from the US Navy’s protection of trade routes and maritime security.
- China benefits from maintaining the current unresolved status of this dispute—and in fact provocations by China, the US or others would be the worst possible outcome.
- Its incentives are to delay negotiations as long as possible, and to deal with neighboring countries on a bilateral basis.

**Defense Spending, 2011-2015, \$bn**

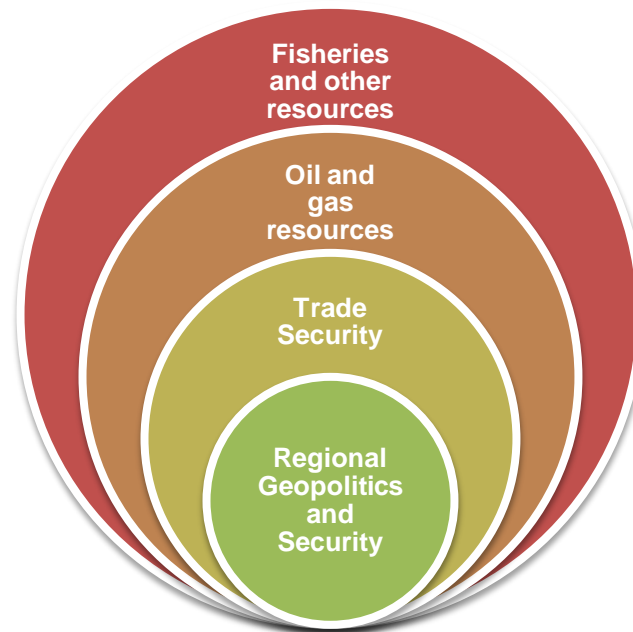


Source: IHS Jane’s

## Larger Context Will Determine Energy Opportunities

Oil and gas policy subject to larger geopolitical concerns

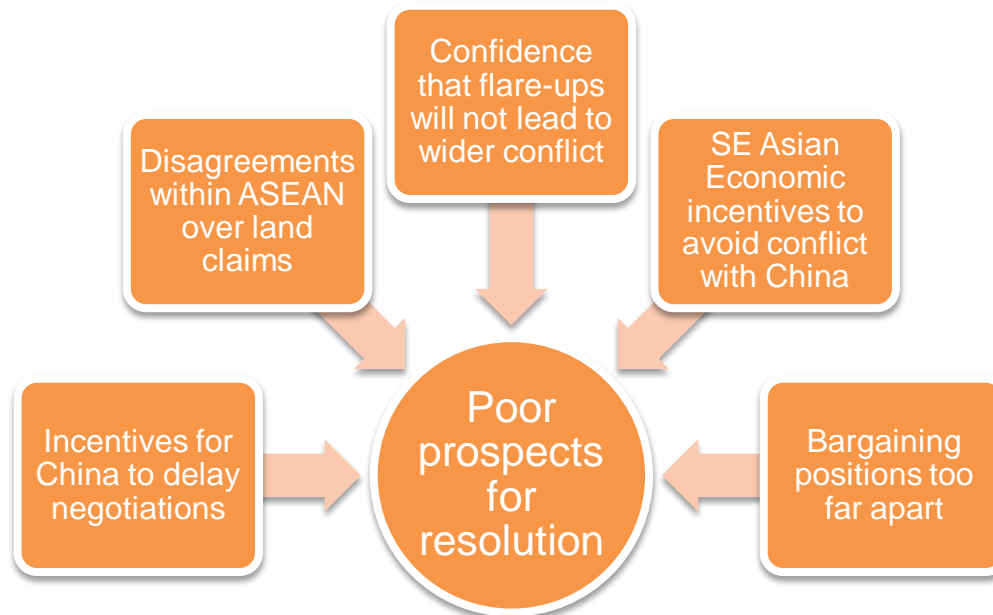
- The South China Sea conflict is often framed – at least in the oil industry – as a struggle for energy resources. But most countries with a stake in the dispute are more concerned over trade security and, in some cases, fisheries.
- Oil and gas resources – considerable, if the USGS reserve and resource estimate of 28 billion boe is to be believed – are substantial but not sufficient to alter the political environment.





## Not Ripe for Resolution

Resolution not likely in the medium term



- Over the medium term (the next five years), a resolution of maritime borders in the South China Sea is unlikely.
- Time is on the Chinese side. Delaying an eventual resolution only strengthens China's leverage. By refusing to negotiate with ASEAN, and emphasizing bilateral deals, China limits each country's bargaining power.
- In the interim, occasional flare-ups and skirmishes are likely, but not a wider war.

## Conclusions

- An ultimate resolution is unlikely in the medium term (next five years)
- Time is on the Chinese side: the longer an agreement is delayed, the more leverage for China
- China prefers bilateral agreements to a China-ASEAN deal
- The US, although more involved in Asian and South China Sea issues, is not well-positioned to broker a deal
- In the interim, flare-ups at sea with drilling or seismic vessels are likely to occur occasionally, but the fallout will probably be contained
- E&P firms with licenses offshore Vietnam or the Philippines will continue to be pressured from the Chinese side

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