

Fuel to the fire

China may be overstating the amount of oil and gas in the South China Sea to bolster its claims



TIMELINE, P36

100 years of vying for the South China Sea

FISH, QUITE A DISH, P38

Asia's seemingly innocuous love of fish may be the likeliest source of a clash

STIR IT UP, P40

China's tangle of agencies and interests could unwittingly spark conflict



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Energy companies have a knack for extracting oil and gas in hostile environments. Whether faced with insurgents, civil war or arctic waters, if there's energy to tap and money to be made, some company will generally be willing to take the risk.

It's no surprise then that oil companies are wading into the contentious South China Sea, where a decades-long sovereignty dispute increasingly threatens East Asian stability. In June, state-owned China National Offshore Oil Corporation (CNOOC) opened bids on areas that overlap with ongoing Vietnamese exploration efforts, causing anti-Chinese protestors to flood the streets of Hanoi. Then, in late July, shortly after a two-month standoff with the Chinese in disputed waters, the Philippines successfully drew a bidder for oil and gas development in two tracts of the sea also claimed by China.

These are just two of a growing number of spats over South China Sea resources during the past three years. In addition to Vietnam, four other countries and territories – the Philippines, Malaysia, Brunei and Taiwan – lay claim to at least some of the broad swathe of sea that Beijing insists is part of China. With so many nations abutting the sea, chance encounters between the boats of rival claimants have on several occasions quickly escalated into a full-on diplomatic crisis.

The stakes are high. The South China Sea contains one of the world's most important shipping routes, forms a buffer zone between sometimes antagonistic states and provides fisheries that are a major food source for the region. In addition, a vast wealth of energy resources may lie underneath the sea floor. With the region's demand for energy growing and domestic resources dwindling, a new oil or gas discovery could push the conflict beyond historic heights.

But energy companies developing the South China Sea may get more trouble and strike less oil and gas than they bargained for. Companies that seek to partner with China, the Philippines or Vietnam to explore for oil and gas in the sea risk becoming political pawns in a strategic fight for sovereignty. In addition, some say surrounding countries are inflating their estimates for the amount of oil and gas resources in the sea in order to solidify the importance of maintaining their claims.

"They don't know – nobody knows what's down there," Damien Ma, China analyst at Eurasia Group, a consulting firm, said of CNOOC's exploration efforts. "Nobody knows how expensive it is, what the overhead costs would be, what the capital injection would be and how long it would actually take."

A history of violence

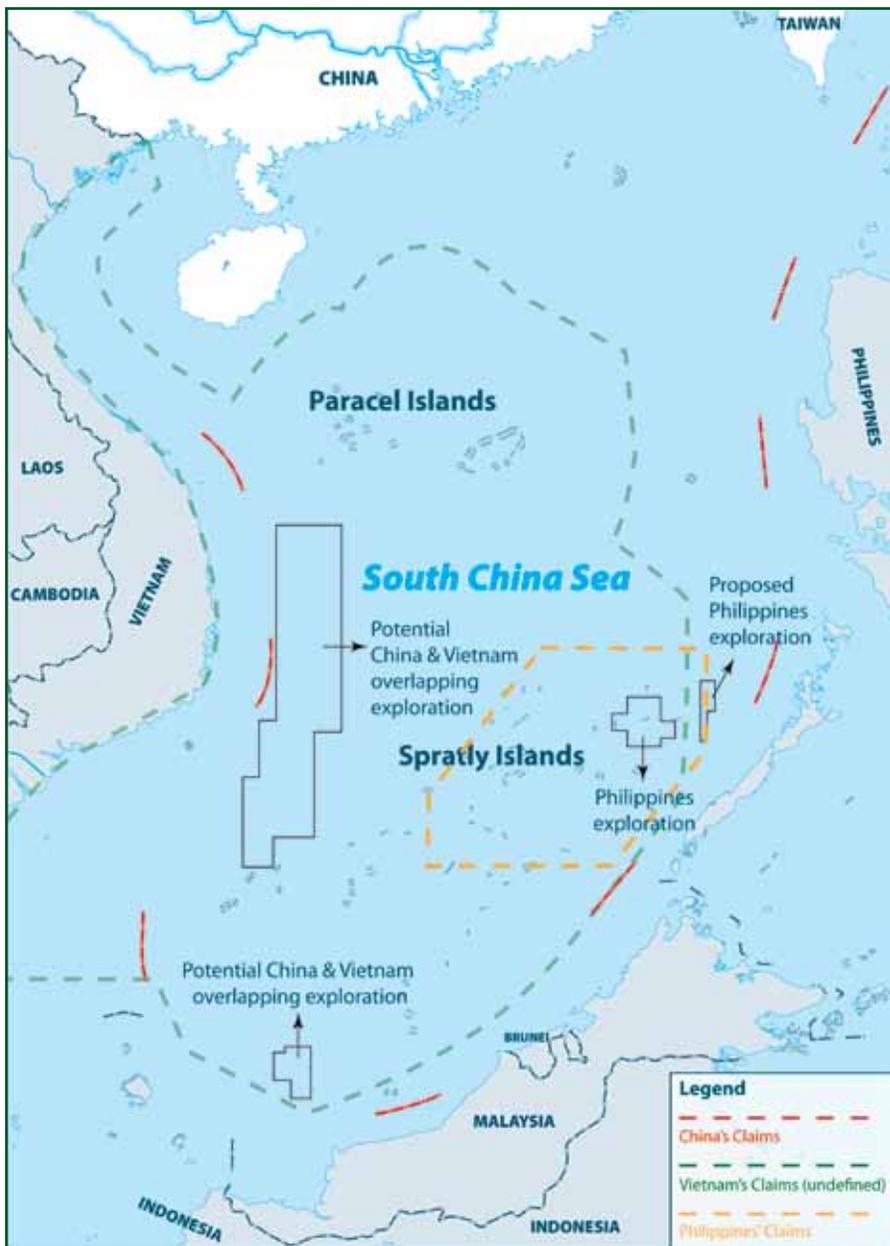
China has patrolled, fished and surveyed the South China Sea since at least the 15th century. Cartographers first included the sea as part of China in 1914, denoting the claim with a nine-dashed line sweeping far south toward the coast of Malaysia. After 1947, the line graced the official maps of both the Nationalist and Communist governments.

But these documents were not enough to convince the world of China's claims. Under the UN Convention on the Law of the Sea (UNCLOS), countries are entitled to claim a 200-nautical-mile exclusive economic zone extending from their coast. That zone gives a country the exclusive rights to resources in those zones, including fishing, oil and gas and wind energy, but does not preclude foreign vessels from traversing the waters. (The zone can extend up to 350 nautical miles if the continental shelf goes beyond 200 nautical miles.)

Depending on how UNCLOS is interpreted, owners of islands and reefs in the South China Sea may be able to claim exclusive economic zones surrounding them. So to solidify its claim to a broader swathe of the sea, China has moved to occupy what parts it could of the Paracel archipelago, the Spratly Islands, and other rocks and reefs beginning with Woody Island in 1950.

This sparked violent clashes with surrounding nations: China fought full-on battles with Vietnam in the 1970s and 1980s, including one that left 70 Vietnamese dead. By the mid-90s, however, most islands and outcroppings were occupied or secured by military patrols, and tensions cooled as China and other countries consolidated their holdings.

Throughout this time, the importance of controlling the South China Sea has continued to grow. Initially a rich source of fish, the sea is also one of the world's most important shipping routes, carrying roughly half of the world's tonnage. In addition, most of China's oil imports travel through the South China Sea, making the body of water vital to national >>



* Map not to scale

>> security. Finally, the sea itself could be an abundant source of gas and oil.

Too much of a good thing

Some describe the South China Sea as a “second Persian Gulf,” potentially one of the richest oil and gas fields in the world. According to varying Chinese estimates, the sea contains the equivalent of between 105–213 billion barrels of oil and gas – enough to supply China for up to 60 years at its 2011 rate of consumption. Even a figure toward the lower end of that range could boost global GDP 0.5–1% by 2020 if development started now, said Mamdouh Salameh, an international oil economist and consultant to the World Bank.

But Chinese estimates are based mostly on speculation and may misrepresent the amount of oil that is accessible, said Clive Schofield, research director and professor at the Australian National Center for Ocean Resources and Security. Working with data from the US Geological Survey, Schofield estimates that only 2.2–7.5 billion barrels of oil and only 18.8 billion barrels of oil equivalent of natural gas would actually be accessible with current drilling technology – a small fraction of China’s estimates. (The US has published its survey data and methodology, whereas China has not released details on its own surveys.)

Claimants to the sea have an incentive to talk up the amount of oil and gas that may exist to emphasize the importance of maintaining their claim, Schofield added. It’s hard to disprove such estimates with the limited amount of exploration that has been done. “There’s an old sort of saying in the oil industry that you don’t know until you drill,” he said.

TIMELINE: 100 years in the South China Sea

The nine-dashed line around most of the South China Sea first appears on a Chinese map, denoting the area as part of China.

Chinese premier Zhou Enlai declares sovereignty over the Paracel and Spratly Islands.

North Vietnam recognizes China’s claims to the Paracel and Spratly Islands in diplomatic notes, despite China’s minimal official presence in both archipelagos.

South Vietnam takes control of the Crescent Group of the Paracel Islands, evicting Chinese fishermen.

China takes full control of the Paracels, defeating the South Vietnamese in a brief battle.

China takes up its first positions in the Spratly Islands, clashing with the Vietnamese and killing 74.

China stops occupying new islands and reefs to focus on consolidating its claims.

India’s ONGC agrees with PetroVietnam to one of its earliest joint production agreements in disputed areas of the sea.

BP ends a joint development deal with Vietnam. Although not confirmed, it is widely believed to be reacting to pressure from China.



1914



1951



1956, 1958



1959



1974



1988



1994



2006



2007

Sources: “Stirring up the South China Sea (I)” by International Crisis Group, “China’s Strategy in the South China Sea” by Taylor Fravel, Reuters, Xinhua, New York Times



ROCK OF AGES: A Chinese force assembles in Sansha, designated a prefecture-level city in July

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But even if the reserves are far lower than expected, a mounting shortfall of energy in China and Southeast Asia is likely to drive countries to pursue development, several analysts said. For example, Salameh noted that the share of China's oil that is produced domestically will shrink from roughly 42% today to only 11% by 2030. China's oil consumption is expected to nearly double between 2011 and 2030, and the three fields that produce most of the country's domestic oil are nearing the ends of their life spans.

"Even if it's not the kind of El Dorado that you sometimes hear talked about, it's still highly attractive from a national

point of view, in terms of energy security," Schofield said.

Motivation for exploration

Vietnam and the Philippines are also looking further offshore for the energy they need as the supply from their onshore and near-shore oil fields wanes. Oil production has leveled off in the Philippines since 2004, according to statistics from the US Energy Information Administration. The Bach Ho offshore field, Vietnam's primary source of oil and gas since its discovery in 1975, is now in terminal decline, and the country is predicted to become a net oil importer within three years.

"As these countries start to see their energy supplies dwindling, particularly the Philippines and Vietnam, this is affecting them now," said Jennifer Richmond, China director for Stratfor, an intelligence and analysis firm. "So they're not waiting two to three years, when they actually know they're going to have an energy crisis."

This spurred Vietnam and the Philippines to launch oil and gas development campaigns in disputed areas, ventures that are far more aggressive than China's efforts. Since 2006, Vietnam has signed deals with US-headquartered Exxon-Mobil, Russia's Gazprom, India's Oil & Natural Gas Corporation (ONGC) >>

A two-month standoff between China and the Philippines over fishing in contested waters ends after vessels withdraw from Scarborough Shoal.

China National Offshore Oil Corporation opens up bids on South China Sea tracts that overlap with Vietnam's existing agreements.

China officially makes Sansha city the administrative authority over the Paracel and Spratly Islands and surrounding waters.

June 18, 2012 June 23, 2012 July 24, 2012



CHICKEN OF THE SEA: Clashes involving fishing boats could be the likeliest source of conflict

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>> and Canada's Talisman Energy to jointly develop areas of the South China Sea that are at least partially claimed by China.

The Philippines signed a deal with UK-listed Forum Energy to develop oil resources near the Reed Bank, where its ships have had previous run-ins with Chinese vessels. The Philippines may also allow further exploration in areas that China claims, as the government held an auction in July for two disputed tracts and received bids from Helios Petroleum and Gas, a domestic energy company.

For Chinese energy companies, by contrast, drilling for oil and gas in the South China Sea is far less attractive. While the Chinese government may want the resources for long-term energy security, CNOOC, the country's primary offshore oil developer, has little incentive to drill in the area when it can find gas more easily and cheaply elsewhere, said Ma of Eurasia Group. "CNOOC already has operations in the Bohai Bay where they're doing drilling. So if they think they can do it cheaper up there, why would they want to invest in the South

'While the likelihood of major conflict remains low, all the trends are in the wrong direction, and prospects for resolution are diminishing'

- INTERNATIONAL CRISIS GROUP

China Sea areas?" Also, China has some lingering security concerns about buying foreign oil, but – unlike the Philippines and Vietnam – its unparalleled economic growth has certainly given it the money to pay for it.

China's bid to secure territory in the South China Sea is instead motivated primarily by sovereignty, multiple analysts said. According to *The New York Times* and subsequent 2010 media reports, Chinese officials supposedly referred to the South China Sea as a "core interest" in meetings with their US counterparts,

a term that is generally used to describe China's claims to Taiwan, Tibet and Xinjiang. "It's somewhat irrational, but sovereignty is sovereignty," Ma said. "For the Chinese, sovereignty is something that they cannot compromise on."

China's top leaders may also be under pressure from their own citizens to take a hard line on the South China Sea. Sovereignty is such a highly nationalistic issue that, if a Chinese leader was seen as acquiescing to Vietnam or the Philippines, it could endanger his or her political career and government legitimacy in the eyes of citizens, said Richmond of Stratfor.

If Vietnam and the Philippines operate unchallenged for extended periods of time, they may also bolster their claims and weaken China's own claims to sovereignty over those areas under international law. So Beijing has periodically tried to disrupt Philippine and Vietnamese exploration, though many of its efforts have been token opposition rather than serious threats. Earlier this year, for example, CNOOC announced that it was accepting bids near Vietnam for >>

► Stir it up: How China's mess of agencies and interests could drag Beijing into conflict

Island living is generally a peaceful affair. The 613 official Chinese residents of Sansha city in the middle of the South China Sea are mostly career fishermen, leading simple but slowly modernizing lives.

In July, the city received what was surely the biggest news in decades: Beijing named Sansha as the administrative center overseeing the Spratly and Paracel islands and surrounding waters. The election of the island's first municipal congress came with plans for a new military garrison on the island, embroiling regional tensions. Vietnam and the Philippines, which both claim areas over which Beijing gave Sansha power, denounced the decision.

But Beijing's strong rhetoric and new military garrison may simply be a feint aimed at deterring Vietnam and the Philippines from asserting more influence in the region. Beijing's central policy toward the sea is to delay any major changes in the status quo, according to Massachusetts Institute of Technology associate professor Taylor Fravel, who specializes in China's territorial disputes.

As several analysts put it, Beijing is following Deng Xiaoping's recommendation that China "hide your brightness, bide your time," in hopes that its next generation of leaders will be in a better position to resolve the conflict.

China is likely to seek to maintain the status quo in the South China Sea throughout its once-in-a-decade leadership transition, in which the vast majority of government offices are handed off to new leadership, said Jennifer Richmond, China director at strategic analysis firm Stratfor.

Beijing's top priority during the transition is maintaining stability. But even after the transition, new leadership is unlikely to change its policy toward the sea, she said.

Beijing treats territorial claims – such as Tibet or Taiwan – as central to national identity, and the South China Sea is viewed in a similar light. Because the presumed next president, Xi Jinping, will need to consolidate his power after the transition, he will be unlikely to risk appearing weak by taking a more concil-

iatory stance.

"If [Xi] is seen as being soft on the South China Sea then his legitimacy and his ability to maintain control would potentially take a nose dive," Richmond said.

Hide and abide

But central government policy may not be enough to avert conflict in the South China Sea. A common myth about China is that Beijing's authority is highly consolidated and absolute, with all lower levels of government falling in line. In reality, a multitude of lower-level agencies have broad leeway to act independently in the South China Sea. Chinese foreign policy watchers refer to this issue as "nine dragons stirring up the sea," a reference to a Chinese legend commonly depicted in classical art.

These actors actually outnumber the dragons in the myth, according to an International Crisis Group report. They include the Bureau of Fisheries Administration, China Marine Surveillance, the provincial governments of Hainan, Guangxi and Guangdong, the PLA navy, the foreign ministry, coast guard, energy companies and others. Beijing has avoided explicitly defining the similarly numbered nine-dashed line – which outlines a wide swathe of ocean as part of China without detailing what rights are claimed to the area – leaving many agencies unsure of what they are supposed to defend. In addition, the Foreign Ministry lacks the clear authority to rein in many of the agencies.

If a run-in between fishermen and

patrol boats of rival nations were to turn violent, an agency such as the China Fisheries Law Enforcement Command responding to the situation could act aggressively in the name of defending Chinese claims. The lack of a unified government structure for dealing with such incidents means that the situation could rapidly escalate before the central government steps in.

In such a situation, those in the government who favor a more forceful approach – not uncommon among the military elite and ambitious politicians who wish to appear strong to shore up support – could appeal to nationalist sentiments to push their case.

One example of this dynamic was the government's tacit approval of anti-Japanese sentiment in 2005, when Japan sought to gain a seat on the UN Security Council. Chinese state media published inflammatory articles on the subject that helped protests spiral out of control and turn violent.

Even leaders with more moderate viewpoints may feel pressured to adopt a more hard-line approach; once mobilized, mass protests can quickly turn against dissenting politicians. The upshot is that Beijing could be dragged into a conflict in the South China Sea, regardless of its wishes.

"[Nationalism] can push politicians and militaries to do things that they may not necessarily want to do," said Michael Auslin, an Asia scholar at the American Enterprise Institute in Washington, DC. "Suddenly they say, 'We're sort of in this, we've got no choice.'" ♦



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>> nine offshore tracts – areas that partially overlap with tracts already being explored by ONGC, Gazprom and ExxonMobil.

The CNOOC announcement was more likely political posturing than an actual push for development, analysts said. Although Chinese media reported that American companies were interested, getting them to tender bids will be far more difficult, said She Boming, vice chairman of the Institute of Southeast Asian Studies in Guangxi province and a professor of economic management. In addition, CNOOC only offers foreign companies minority stakes in the tracts, making bidding less attractive.

“I think CNOOC’s offshore auction to foreign companies is more of posturing since it is China’s leading state-owned offshore oil company, but there are huge difficulties in implementation,” She said. Vietnam and other members of the Association of Southeast Asian Nations could move to block China, he said, since the tracts lay within Vietnam’s claimed 200-mile exclusive economic zone.

Posturing or no, the actions of claimant nations are increasing the risk of



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COLOR GUARD: The crew of a Chinese submersible heads for a dive in the South China Sea

conflict. A report released in late July by the International Crisis Group summed up the outlook for the South China Sea: “While the likelihood of major conflict remains low, all the trends are in the wrong direction, and prospects for resolution are diminishing.” The more tensions rise, the less room China, Vietnam and the Philippines have to back down with-

out provoking a nationalist backlash (see box on opposing page).

Tensions ahead

Clashes between rival claimants are also likely to increase. Oil companies will venture deeper into the sea as their near-shore resources dwindle, and fishermen are also likely to travel farther from the >>

>> coasts as fishing stocks are gradually depleted (see box on page 38). China's various marine agencies have additionally increased patrols in the South China Sea to regulate fishing or other operations in areas China claims.

All this activity has increased the risk of conflict. "How many more times do you have to do this stuff, meaning have a standoff for a month in Scarborough Shoal, before someone fires, someone decides I don't want to wait around any longer? We just don't know," said Michael Auslin, a resident scholar in Asian studies at the American Enterprise Institute in Washington, DC.

Tensions could spike if companies strike more oil or gas in the near future, said Taylor Fravel, an associate professor at the Massachusetts Institute of Technology who specializes in China's territorial disputes. Countries would likely move aggressively to ensure they are not shut out from development of a lucrative field.

But once initial tensions subside, countries may be able to come to a solution so that all sides benefit. "That would probably only occur after things got pretty ugly for a while," Fravel said. "Once sober

The more tensions rise, the less room China, Vietnam and the Philippines have to back down without provoking a nationalist backlash

minds prevail, and people thought, 'OK, if there is a big find, how are we going to develop it?' [Then] you're going to have to get cooperation."

For example, if a typhoon endangered Chinese workers on a deep water drilling operation far from the shores of the mainland, they would likely need help from surrounding countries, he said. Alternatively, China could face steep technical problems bringing natural gas from a far flung gas field in the South China Sea back to its shores, a problem which could be solved by partnering with a nearby country.

A 2008 deal between China and Japan provides one model for how joint development could go forward, Fravel

said. The two sides skirted the sovereignty issue by agreeing that development of the Chunxiao gas field, which stretches through disputed areas of the East China Sea, could go forward "without prejudicing their respective legal positions." The deal clearly laid out the latitudes and longitudes within which development could take place.

But the odds of replicating this agreement in the South China Sea are slim. Most likely all sides will seek to maintain the status quo: Vietnam and the Philippines will slowly proceed with exploration only to be countered by Chinese rhetoric and token measures to assert sovereignty. Forging an agreement that divorces international joint development from sovereignty issues would only be possible in the unlikely event that there is a long period in which tensions ease.

"There's no way to really do that. Energy, economics and politics are so tightly intertwined in East Asia," said Richmond of Stratfor. "The only way is for these countries to come together in joint venture projects, and that's difficult at best." ♦

