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## **Energy Competition in the South China Sea: A Front-burner Issue?**

*By Euan Graham*

### **Synopsis**

*Recent events have refocused attention on energy as a potential driver of tensions in the South China Sea.*

### **Commentary**

The recent confrontation between Vietnam and China, over the latter's deployment of a deep-water drilling rig in disputed waters, has refocused the spotlight on energy in the South China Sea. How important is it as a driver in China's South China Sea policy? To what extent is competition over seabed hydrocarbons compounding tensions between China and Southeast Asian territorial claimants?

In fact, political and strategic motivations almost certainly took precedence over energy considerations in the decision to deploy China National Offshore Oil Corporation's (CNOOC's) deep-water platform west of the Paracels, in early May 2014. Nevertheless, the imperative to exploit seabed energy resources has received greater attention within China's overall South China Sea policy in recent years.

### **China's pursuit of maritime power**

China is now the world's largest oil importer, a simple fact that has increased its exposure to political risk in the Middle East and Africa, to potential disruption in transit, as well as growing competition to secure new upstream resources. China is thought to be topographically disadvantaged when it comes to exploiting its shale deposits. Exploiting offshore energy within China's "near seas" is therefore seen as an attractive option from a supply-security perspective against projections for future demand growth.

A heightened focus on energy exploration and securing a greater share of oil and gas resources in the South China Sea, unilaterally if necessary, has emerged in internal Chinese policy debates over the past five years. This has fed into a major capability upgrade for China's state-owned energy conglomerates, including acquisitions of deep-water rigs, seismic survey vessels and support craft that are now becoming operational.

Alongside expansion of the merchant fleet, ports infrastructure and naval modernisation, the development of the offshore energy sector can be considered as another key pillar in the Chinese leadership's pursuit of comprehensive "maritime power".

CNOOC first announced plans to invest \$30 billion on deep-water projects, over two decades, in 2009. A second deep-water drilling platform is scheduled for completion in 2016 and is specifically designed to operate in the South China Sea. For CNOOC and China's other state-owned energy firms this brings a step-change for exploration and production (E&P) activity in the South China Sea at large. In this context, the stand-off with Vietnam is more likely to be a rehearsal than an isolated incident.

As the number of China's deep-water rigs increases, their deployment further afield is likely to become more common, although the logistical and security challenges for long-distance E&P operations in the southern portions of the South China Sea are significant. This helps to explain the choice of the Paracels for the first deployment, being relatively close to Hainan.

### **Hydrocarbons deposits**

The growth of China's offshore E&P capabilities has proceeded hand-in-glove with the expansion and centralisation of its maritime law enforcement capacity, which is tasked with protecting these high-value assets as they venture further out into disputed waters. A pattern of close cooperation was evident throughout CNOOC's deep-water platform's turbulent six-week deployment, in which law enforcement vessels provided an outer security cordon around an inner core of support craft surrounding the platform itself.

That the South China Sea is energy-rich is not in doubt, including oil and gas fields off China's Pearl River Delta and Hainan. But the underlying geology points to a concentration of hydrocarbons deposits around the periphery and the sea's southern half in particular, economically advantaging Malaysia, Brunei, Indonesia, Vietnam and the Philippines. A 2010 US geological survey estimated the untapped energy potential of the South China Sea at 11 billion barrels of oil and 145 trillion cubic feet of gas.

Much larger estimates by Chinese sources remain uncorroborated. Deep-water areas of the South China Sea are abundant in methane hydrates, but the recovery of natural gas from these deposits is a long-term proposition at best.

While a major strike in unsurveyed portions of the South China Sea cannot be ruled out, industry analysts question the energy potential of the Spratly and Paracel Islands and surrounding waters. This may have the effect of drawing China's E&P activity south over time, raising the stakes of further confrontations and stand-offs in the Exclusive Economic Zones (EEZ) of Southeast Asian littoral states, where these overlap with China's ambiguous dashed-line claims.

Malaysia, Brunei and Indonesia have been producing energy in the southern South China Sea for decades, while Vietnam and the Philippines are newer entrants. Vietnam has moved rapidly to exploit offshore energy within its EEZ. Owing to large discoveries in the Nam Con Son and Cuu Long basins, Vietnam is a petroleum exporter but still imports refined products. The Philippines is pumping gas from the Malampaya field and has made new discoveries at Reed Bank.

### **Impact of energy exploration**

Most Southeast Asian producers rely on joint ventures with foreign partners, though Malaysia's Petronas stands out as a global player with diverse upstream and downstream investments. China's energy companies also operate globally on a for-profit basis, and their profile as investors in Southeast Asia is naturally expected to grow.

However, political and strategic imperatives can take precedence especially within the "near seas", as was the case with the deployment of CNOOC's deep-water platform in May. Equally, the decision to withdraw prematurely, in July, suggests a political motive – though such signals have to be inferred.

Vietnam has sought a deliberately diverse portfolio of JV partners, granting block concessions to Russian, Indian, Malaysian, US, and European-listed energy firms, with the implied aim of internationalizing its maritime claims. Vietnam has recently offered India's ONGC-OVL five additional oil and gas blocks in the South China Sea for exploration, although the company's existing Vietnamese concessions have yielded disappointing results.

A reactive dynamic can therefore be seen at play in the South China Sea, whereby energy exploration by Vietnam and the Philippines has fanned China's fears of "losing out", prompting a significant policy shift since 2009 away from the joint development paradigm to unilateral E&P, including within disputed waters. To this can be added the physical disruption of energy surveys undertaken by foreign firms exploring under license within the EEZs of Vietnam and the Philippines.

Vietnam and the Philippines are concerned that the geographical pattern of maritime incidents and the growing presence of Chinese vessels further south in the South China Sea owes at least in part to the proximity of oil and gas. The Philippines recently protested against the regular presence of Chinese survey vessels in Reed Bank, alleging that this contravenes innocent passage within its EEZ.

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