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TERRITORY DISPUTES IN THE SOUTH CHINA SEA

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TERRITORY DISPUTES IN THE SOUTH CHINA SEA

IMPACT ON REGIONAL SECURITY, NATURAL RESOURCES, AND
INTERNATIONAL TRADE

RISK REPORT

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Summary

This Risk Report highlights the connection of territorial disputes in the South China Sea with security, trade, and energy-related factors. As a pivotal point of international maritime trade, military conflict in the South China Sea would inhibit safe trade in the region and have devastating effects on the global economy. This would not only affect China, which plays a key role in the territory dispute, but also a large part of the Asia-Pacific, the Middle East, the United States, and, by extension, Europe.

List of Abbreviations:

ASEAN	Association of Southeast Asian Nations
BRI	Belt and Road Initiative
CNOOC	China National Offshore Oil Company
EEZ	Exclusive Economic Zone
FONOP	Freedom of Navigation Operation Program
LNG	Liquefied Natural Gas
NATO	North Atlantic Treaty Organization
UNCLOS	United Nations Conventions on the Law of the Sea
USGS	United States Geological Survey

BOLTS: STRATEGIC, OPERATIONAL, FINANCIAL, AND COMPLIANCE.

TAGS: SOUTH CHINA SEA, CHINA, PHILIPPINES, BRUNEI, MALAYSIA, VIETNAM, TAIWAN, FISHING, RESOURCE COMPETITION, OIL AND GAS, TERRITORY DISPUTES, INTERNATIONAL TRADE, ENERGY SUPPLY, DETERRENCE, ASEAN.

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Territory of the South China Sea

Several regional powers lay claim to territory in one of the most disputed waters in the world: The South China Sea. It is encircled by China, the Philippines, Brunei, Malaysia, Vietnam, and Taiwan. In addition to these countries, the United States, Japan, South Korea, Middle Eastern and European countries also have a stake in the military standoff within the South China Sea. The stretch of water connects two of the world's major seas, the Indian Ocean and the Northern Pacific Ocean, and is one of the most important international trading routes. It is rich in fisheries and natural resources such as oil and natural gas, making it a strategically attractive area in which to engage in military gambits.

The South China Sea comprises hundreds of reefs and islands varying in size. The most prominent among them are the Spratly Islands, the Paracel Islands, the Scarborough Shoal, Macclesfield Bank, and the Pratas Reef. Most of the islands are uninhabited¹, a fact that makes solving the question of ownership difficult. The Spratly group, which consists of approximately 40 islands², is a particularly contested area, claimed in its entirety by China, Taiwan, and Vietnam, and claimed in part by the Philippines, Malaysia, and Brunei.

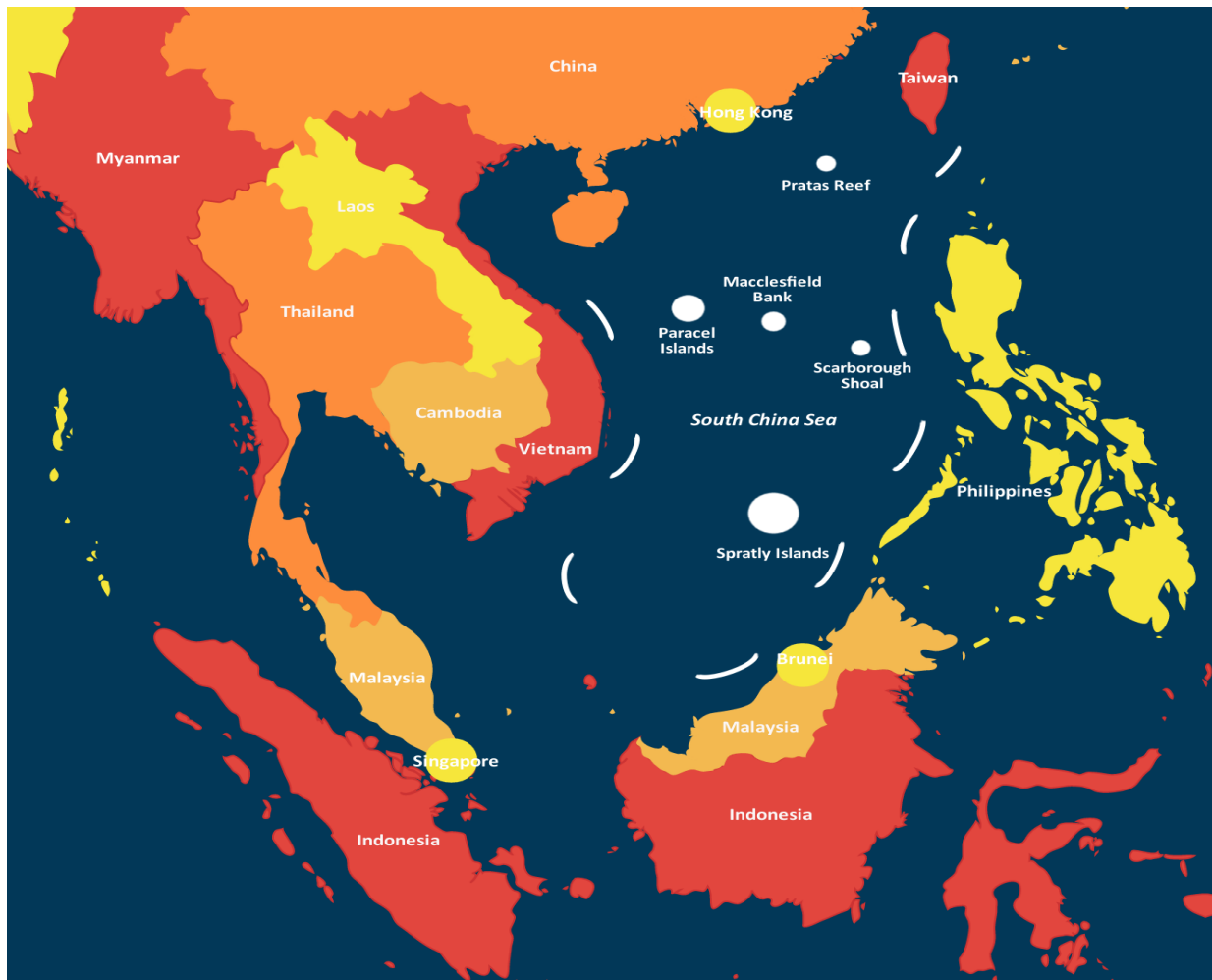
Territory disputes have been largely incited by China's contentious strategy to integrate roughly 90%³ of the South China sea into its dominion. China's approach to claiming the sea is called the nine-dash line (see Map 1), which was drawn after World War II when defeated Japan had to relinquish control over the waters. This arbitrary seizure of control contradicts present-day international maritime law and raises tensions among China, Southeast Asian countries, and the West. Hostile standoffs and military maneuvers between China, the United States, and the Philippines have caused serious concern over the possibility of war in the South China Sea.

¹ Xu, B. (2014) *South China Sea tensions*, Council on Foreign Relations. Available at: <https://www.cfr.org/backgrounder/south-china-sea-tensions> (Accessed: April 22, 2019).

² Morton, K. (2016) *China's ambition in the South China Sea: Is a legitimate maritime order possible?*, *International Affairs*, 92(2), p.917. Available at: <https://www.chathamhouse.org/publication/ia/china-s-ambition-south-china-sea-legitimate-maritime-order-possible> (Accessed: April 22, 2019).

³ Panda, A. (2019) *With new South China Sea tensions with Philippines, China overplays its hand*, *The Diplomat*. Available at: <https://thediplomat.com/2019/04/with-new-philippine-tensions-china-overplays-its-hand/> (Accessed: April 22, 2019).

What makes the South China Sea crisis so complex is the fact that security risks, economic interests, and multilateral cooperation patterns interweave in this area. Differences in power and military strength influence the extent to which involved parties can apply leverage in order to further their interests. A potential war sparked by China's seizure of territory would inhibit international trade and energy supply since cargo vessels could no longer safely traverse this vital trading route.



Map 1: The Nine-Dash Line Claimed as Sovereign Territory by China.

Military Security and Defense

The main source of military tensions between China and other Asia-Pacific states is the U-shaped nine-dash line, which incorporates three major anchor points in the South China Sea into China's

territory. These are the Spratly Islands, the Paracel Islands and the Scarborough Shoal. In 1947⁴, the government in Beijing published a map with nine lines demarcating a far-reaching area as China's sovereign territory and later forwarded this map to the United Nations in 2009⁵ to emphasize its point. Three years later, China released new passports containing a map of the claimed waters and subsequently faced international criticism⁶.

A major security risk for regional powers is the lack of a strong and durable defense pact in Asia such as the North Atlantic Treaty Organization (NATO) that could counterbalance China's encroachment. The largest coalition of regional states is the Association of Southeast Asian Nations (ASEAN), but the function of this coalition between the Philippines, Malaysia, Vietnam, Brunei, Indonesia and other Southeast Asian countries is focused on economic cooperation and development rather than regional security. Defense strategies in Southeast Asia are comparatively vulnerable and rely on bilateral or multilateral partnerships with other Asia-Pacific countries and the United States.



International Maritime Law

While China's authorities offer historical explanations for their sovereign rule over the disputed waters, the Philippines, Brunei, Malaysia, Vietnam, and Taiwan challenge this claim by referring to international maritime law. The 1994 United Nations Conventions on the Law of the Sea (UNCLOS)

⁴ Rosenberg, D. (2010) *Governing the South China Sea: From freedom of the seas to ocean enclosure movements*, *Harvard Asia Quarterly*, XII (3 & 4), p.11.

⁵ Xu (2014) *South China Sea tensions*. (Accessed: April 22, 2019).

⁶ *Ibid.*

defines legal regulations regarding the sovereign rule of a coastal state over maritime territory in Part V on the Exclusive Economic Zone (EEZ). The international treaty states that any waters in a reach of 200 nautical miles from a country's shores belong to that very country's sovereign territory, whereas the sea beyond this zone is international waters and cannot be claimed by anyone⁷. Furthermore, the treaty asserts that states have the right to manage, exploit, and build artificial islands within the boundaries of their EEZ without interference from foreign states⁸. Despite the fact that China has ratified this international treaty, the actions of the Chinese government indicate a position that stands in stark contrast with its legal obligations. The nine-dash line stretches far beyond China's lawful 200 nautical mile zone and overlaps with the Exclusive Economic Zones of all neighboring countries in the South China Sea – the Philippines, Brunei, Indonesia, Malaysia, and Vietnam.



⁷ United Nations (1994) *United Nations Convention on the Law of the Sea, Part V: Exclusive Economic Zone*. Available at: https://www.un.org/Depts/los/convention_agreements/texts/unclos/part5.htm (Accessed: April 25, 2019).

⁸ Ibid.

China's hegemonic ambitions in the South China Sea have increased tensions to the extent that the Philippines took the matter to the Permanent Court of Arbitration in The Hague in January 2013. The court ruled in favor of the Philippines in July 2016, arguing that China's historical claims to the South China Sea concluded in 1996 when the country signed the UNCLOS and submitted to EEZ regulations⁹. Therefore, it is the Philippine government's sole right to drill for natural resources within its EEZ around the Scarborough Shoal and the Spratly group. The court's ruling, however, did not induce significant effect on the foreign policy of the Chinese government as it continued to engage in saber-rattling maneuvers with its neighbors.

In 2017, Beijing warned Vietnam to stop drilling for oil in Vietnamese offshore territory within the nine-dash line. Afraid that it would not receive international backing on this issue, Vietnam consequently halted its operations¹⁰. Two years later, in March 2019, the government in Beijing reaffirmed its foreign policy towards Vietnam when a Chinese surveillance vessel sank a Vietnamese fishing boat¹¹.

What triggers hostilities and distrust towards China is not only Beijing's military action in the South China Sea but also its confidence in legal matters. China maintains that foreign countries would need to obtain its permission in order to collect intelligence, conduct scientific observations, or carry out military activities in these waters¹². Therefore, any state would be required to attain authorization from China if it pursued activities such as research expeditions or drilling for natural resources within the nine-dash line. Non-aggressive military actions such as surveillance maneuvers fall within a legal grey area. Chinese authorities insist that such actions are not permissible, but the U.S. still deploys navy and air forces to offset China and demonstrate military counterbalance capabilities.

⁹ ***The South China Sea Arbitration (The Republic of the Philippines v The People's Republic of China)*** (2016) 2013-19. Available at: <https://pca-cpa.org/en/cases/7/> (Accessed: April 25, 2019).

¹⁰ **Hayton, B. (2017) The week Donald Trump lost the South China Sea, *Foreign Policy***. Available at: <https://foreignpolicy.com/2017/07/31/the-week-donald-trump-lost-the-south-china-sea/> (Accessed: April 25, 2019).

¹¹ **Vu, K. (2019) Vietnam protests to China over South China Sea boat sinking, *Reuters***. Available at: <https://www.reuters.com/article/us-vietnam-southchinasea-idUSKCN1R3070> (Accessed: April 25, 2019).

¹² **Rosenberg (2010) *Governing the South China Sea*, p.12.**

China's arbitrary behavior can be classified as a threat to international order and legal regimes. While international law is based on consensual treaties and court rulings, the Chinese government chooses to prioritize national interests over international legal obligations. This stance may raise the question whether the Philippines, Malaysia, Brunei, Indonesia, Vietnam, and Taiwan should also disregard international maritime laws to protect and advance their interests. Such an endeavor, however, requires military and economic strength. As a global player, China overpowers its neighbors and therefore can exert considerable pressure. Moreover, if Southeast Asian states decided to disregard legal norms as well, adherence to the international rules-based order would be destabilized and imperiled.

China

China's approach is one that both heightens and reduces risks of violent conflict in the South China Sea. The East Asian state clearly demonstrates supremacy through military action and displays of power. In April and May 2018, Chinese forces added anti-ship missiles, surface-to-air missiles, long-range bombers and electronic jammers to its military arsenal in both the Spratly Islands and Paracel Islands¹³. In addition, President Xi Jinping chaired China's most extensive naval demonstration of power to date in April 2018. This parade in the South China Sea comprised 100,000 naval officers, 76 fighter jets and a flotilla of 48 warships and submarines¹⁴.

The number of islands occupied by China in the South China Sea is steadily increasing. In 2012, Chinese forces took control of Scarborough Shoal, frustrating the Republic of the Philippines' efforts to defend the territory as its own. A year later, China began to build artificial islands amounting to

¹³ Kuok, L. (2018) Countering China's actions in the South China Sea, *The International Institute for Strategic Studies*. Available at: <https://www.iiss.org/blogs/analysis/2018/08/countering-china-south-china-sea> (Accessed: April 22, 2019).

¹⁴ Wen, P., Jim, C., and Chopra, T. (2018) China's Xi presides over large-scale naval display in South China Sea, *Reuters*. Available at: <https://www.reuters.com/article/us-china-military-xi/chinas-xi-presides-over-large-scale-naval-display-in-south-china-sea-idUSKBN1HJ27M> (Accessed April 25, 2019).

3,200 acres of land in the Spratly group¹⁵ to reinforce its presence in the waters. In total, China occupies 20 maritime features in the Paracel Islands and 7 in the Spratly Islands¹⁶. China's rapid takeover of territory and expansion of presence in the disputed waters endangers the stability of regional security since



countries in the Asia-Pacific and the United States would be drawn into military conflict to protect their own interests. These concerns range from security issues, power struggles, and economic interests to sufficient energy supply from the Middle East.

It is evident that China has increasingly taken the offensive in the disputed territory. Consequently, China and its neighbors have laid stronger focus on defense expenditures and military deterrence. In its entirety, the Asia-Pacific region including China, Japan, South Korea, the Philippines, Vietnam, India, Pakistan, and Australia have spent 450 billion USD on military defense since the year 2000. Out of that amount, China's share reaches over 200 billion USD¹⁷, indicating the military strength China's opponents would have to anticipate in the event of conflict.

¹⁵ Center for Strategic and International Studies (2019) *China Island Tracker*, *Center for Strategic and International Studies: Asia Maritime Transparency Initiative*. Available at: <https://amti.csis.org/island-tracker/china/> (Accessed: April 26, 2019).

¹⁶ *Ibid.*

¹⁷ Smyth, J. (2018) *Battle stations: Asia's arms race heats up*, *Financial Times*. Available at: <https://www.ft.com/content/4492a134-9687-11e8-b67b-b8205561c3fe> (Accessed: April 26, 2019).

Vietnam

As one of China's immediate neighbors, Vietnam has increased its military expenses from 4.1 billion USD in 2013 to 6.6 billion USD in 2018¹⁸. In response to China's behavior in the South China Sea, Vietnam's government in Hanoi increased its arms trade with Russia and India¹⁹, built up its coast guard and fisheries surveillance, and invested in three contracts worth 2.5 billion USD in order to add 32 more Sukhoi Su-30MKKs to its air force between 2009 and 2013²⁰. This illustrates that Vietnam perceives China's encroachment in the South China Sea as a serious threat to its security.

Malaysia

Compared to Vietnam, Malaysia's defense expenditures have been relatively stagnant in reaction to China's behavior in the South China Sea. Until 2013, Malaysia did not expand its defense budget or focus on the modernization of its military force. In 2013, after China's navy performed exercises 55 nautical miles off Malaysia's Borneo coast and anchored at the South Luconia Shoal 70 nautical miles off the Borneo coast in order to tap into natural oil reserves, Malaysia started developing its coast guard²¹. Additionally, Malaysia's government committed to a defense pact with East Asian partner Japan, whom the country shares security concerns with regarding China's maritime strategies²². Although Malaysia's investment into military defense is comparatively meager, the country's behavior reveals a certain concern with China as a security threat near its shores.

¹⁸ Ibid.

¹⁹ Xu (2014) South China Sea tensions. (Accessed: April 22, 2019).

²⁰ Vuving, A. (2017) Tracking Vietnam's force build-up in the South China Sea, *Center for Strategic and International Studies: Asia Maritime Transparency Initiative*. Available at: <https://amti.csis.org/tracking-vietnams-force-build-south-china-sea/> (Accessed: April 25, 2019).

²¹ Ibid.

²² Parameswaran, P. (2018) What's in the new Japan-Malaysia defense pact?, *The Diplomat*. Available at: <https://thediplomat.com/2018/09/whats-in-the-new-japan-malaysia-defense-pact/> (Accessed: April 26, 2019).

The Philippines

The fact that the Philippines raised its military spending from 2.7 billion USD in 2013 to 4.4 billion USD in 2018²³ reveals that the country is preparing to defend its EEZ against Chinese advances. Between January and March 2019, the Philippines reported that approximately 275 Chinese naval vessels were sighted close to Thitu Island in the Spratly group, which is occupied by the Philippines. Philippine President Rodrigo Duterte saw clear peril in China's advances, threatening suicide missions to fend off Chinese ships²⁴.

Although the Armed Forces of the Philippines started enhancing its maritime defense with barracks and water systems on the Spratly Islands in 2017²⁵, the country would still be unable to defeat Chinese forces without external aid. This explains the Southeast Asian state's move to strengthen ties with the United States. The two countries have been mutual security partners ever since a bilateral defense treaty was signed in Washington, D.C. in 1951. This commitment ensures that attacks against Philippine defense forces in the South China Sea will entail U.S. military action in response²⁶. The annual joint military Balikatan exercises between U.S. and Philippine forces emphasize mutual relations. In April 2019, the Philippines, the U.S., and Australia joined forces in the largest Balikatan exercises since 2016, deploying 7,500 soldiers in total²⁷. Being backed by U.S. and Asia-Pacific partners decreases the risk that the Philippines will be expelled from the South China Sea by the Chinese military. At the same time, a multilateral military build-up could escalate tensions with China and plunge involved parties into open battle.

²³ Smyth (2018) Battle stations. (Accessed: April 26, 2019).

²⁴ Lopez, D. B., and Calonso, A. (2019) Duterte stakes rare claim, tells China to 'lay off' Thitu Island, *Bloomberg*. Available at: <https://www.bloomberg.com/news/articles/2019-04-05/duterte-stakes-rare-claim-tells-china-to-lay-off-thitu-island> (Accessed: April 26, 2019).

²⁵ Panda, A. (2017) South China Sea: Philippines plans Spratly upgrades, *The Diplomat*. Available at: <https://thediplomat.com/2017/10/south-china-sea-philippines-plans-spratly-upgrades/> (Accessed: April 25, 2019).

²⁶ Panda (2019) New South China Sea tensions. (Accessed: April 22, 2019).

²⁷ Cruz de Castro, R. (2019) Balikatan 2019 and the crisis in Philippine-China rapprochement, *Center for Strategic and International Studies: Asia Maritime Transparency Initiative*. Available at: <https://amti.csis.org/balikatan-2019-and-the-crisis-in-philippine-china-rapprochement/> (Accessed: April 26, 2019).

The United States

U.S. involvement in the South China Sea revolves to a large extent around great power politics. China's dominance in these waters not only risks a destabilization of regional security but it also reinforces power rivalry with the United States. Worsening relations between the U.S. and the People's Republic of China can be observed in Washington's decision to exclude the People's Liberation Army Navy, the warfare-focused faction of the Chinese navy, from its list of 26 participants in the 2018 Rim of the Pacific Exercise²⁸. This event is the world's largest cooperative maritime warfare exercise and had previously included China as a participant.

One of the United States' strategies to deter further Chinese action is the freedom of navigation operation program (FONOP). Defending maritime security, the rule of law, and uninhibited passage of ships and aircrafts in and above international waters, U.S. naval ships have navigated through the South China Sea to counteract China's dominance. As these waters are among the most disputed worldwide, it may not come as a surprise that most of the United States' FONOPs are executed in the South China Sea²⁹. While patrolling the sea bears symbolic significance, it also creates greater frictions between Washington, D.C. and Beijing. Attempting to push U.S. forces out of contested zones, China has displayed progressively combative behavior. A collision between Chinese destroyer CNS Lanzhou and the United States' destroyer USS Decatur in September 2018 illustrates this point. The USS Decatur was sighted by the Chinese navy in a perimeter of 12 nautical miles from the Gaven and Johnson reefs in the Spratly Islands during a FONOP³⁰. In the past, Chinese forces would have simply observed and warned U.S. ships, but the straightforward maneuver by the CNS Lanzhou suggests that China is increasingly ready for combat. It seems unlikely, however, that the U.S. will retreat from the sea as it will not dismiss the principle freedom of navigation and

²⁸ **United States of America Navy (2018) U.S. Navy announces 26th Rim of the Pacific Exercise. Available at: https://www.navy.mil/submit/display.asp?story_id=105789 (Accessed: April 26, 2019).**

²⁹ **Dutton, P. A., and Kardon, I. B. (2017) Forget the FONOPs: Just fly, sail and operate wherever international law allows, *Lawfare*. Available at: <https://www.lawfareblog.com/forget-fonops-%E2%80%94-just-fly-sail-and-operate-wherever-international-law-allows> (Accessed: April 22, 2019).**

³⁰ **Choong, W. (2018) Why the US Navy should press on with its South China Sea missions, *The International Institute for Strategic Studies*. Available at: <https://www.iiss.org/blogs/analysis/2018/10/us-navy-south-china-sea-missions> (Accessed: April 22, 2019).**

grant China such a substantial gain in power. Therefore, military conflict between these two powerful states is within the range of possible outcomes.

The fact that not only regional powers and the U.S. but also other Asia-Pacific and European states partake in South China Sea affairs increases frictions additionally. One factor that renders the South China Sea an area of high tension is the Quadrilateral Security Dialogue between Japan, the United States, India, and Australia, which was initiated by Japanese Prime Minister Shinzo Abe in 2007. After Australia withdrew a year later, 'The Quad' was put to a halt. Eventually, in 2017, the four states re-engaged in the strategic security partnership. In addition, France and the United Kingdom are also represented by naval vessels in the disputed waters in order to defend the international rules-based order and monitor China's claims to power.

ASEAN-China Negotiations

Efforts to lower tensions in the contested waters can be found in ASEAN-China negotiations regarding a South China Sea Code of Conduct. The goal of the code is to stabilize and strengthen regional relations through cooperation and to aim for a peaceful settlement of disputes³¹. A potential template for dispute management can be the Treaty of Amity and Cooperation in Southeast Asia of 1976, in which the importance of territorial integrity and the peaceful resolution of a dispute is



³¹ Thayer, C. (2018) A closer look at the ASEAN-China Single Draft South China Sea Code of Conduct, *The Diplomat*. Available at: <https://thediplomat.com/2018/08/a-closer-look-at-the-asean-china-single-draft-south-china-sea-code-of-conduct/> (Accessed: April 29, 2019).

highlighted³². The treaty was signed by Southeast Asian states and did not include China, but it could offer guidance on future agreements. The issue that China may sign a treaty but adhere to it only arbitrarily still remains. China may decide to evade multilateral agreement responsibilities due to its status as great power and progressively frustrate ASEAN states.

Natural Resources

A main reason for rising tensions is the abundance of natural resources in the South China Sea. According to calculations by the U.S. Energy Information Administration, the South China Sea harbors 11 billion barrels of oil and 190 trillion cubic feet of natural gas in discovered and presumed reserves³³. The China National Offshore Oil Company (CNOOC), China's major oil and gas producer, estimates an even larger amount of 125 billion barrels of oil and 500 trillion cubic feet of natural gas³⁴. In comparison, China's Ministry of Land and Resources reports that 23-30 billion tons of oil and 16 trillion cubic meters of natural gas can be found within the nine-dash line, amounting to 12% of global reserves³⁵.

An analysis of undiscovered oil and gas reserves in Southeast Asia by the U.S. Geological Survey (USGS) from 2010 reveals areas that possess the greatest amount of natural resources in the South China Sea³⁶:

³² ASEAN (1976) *Treaty of Amity and Cooperation in Southeast Asia*. Available at: <https://asean.org/treaty-amity-cooperation-southeast-asia-indonesia-24-february-1976/> (Accessed: April 29, 2019).

³³ U.S. Energy Information Administration (2013) *South China Sea*. Available at: <https://www.eia.gov/beta/international/regions-topics.php?RegionTopicID=SCS> (Accessed: April 29, 2019).

³⁴ Morton (2016) *China's ambition in the South China Sea*, p.915.

³⁵ Li, G. (2015) *China Sea oil and gas resources*, *China Institute of International Studies*. Available at: http://www.ciis.org.cn/english/2015-05/11/content_7894391.htm (Accessed: April 29, 2019).

³⁶ U.S. Geological Survey (2010) *Assessment of Undiscovered Oil and Gas Resources of Southeast Asia, World Petroleum Resources Assessment Project*. Available at: <https://pubs.usgs.gov/fs/2010/3015/pdf/FS10-3015.pdf> (Accessed: April 29, 2019).

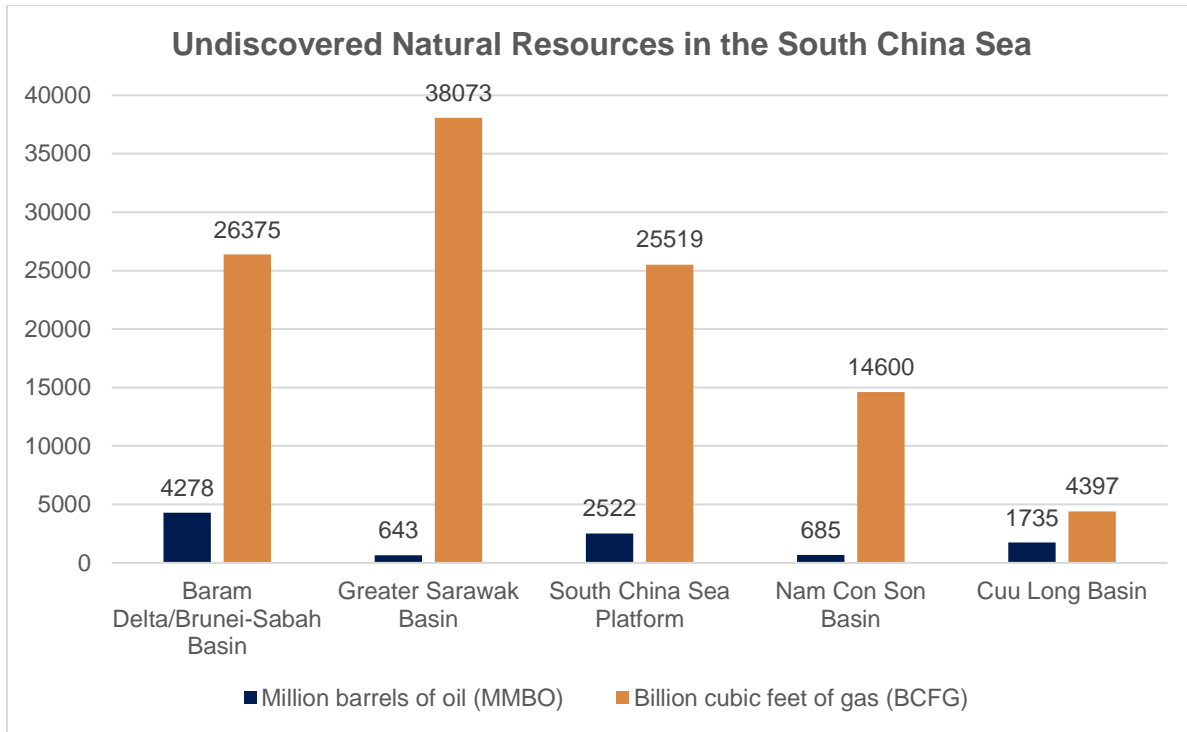


Table 1: Areas with the greatest presumed amounts of oil and gas resources in the South China Sea.

While estimates may vary, the data shows that the over 200 companies³⁷ looking for natural gas and oil in the South China Sea anticipate a wealth of natural resources hidden in these waters. The CNOOC conducted oil drilling operations in the Eastern and Western South China. In late 2017, the business reported that it had extracted 533.7 million barrels of oil in the Eastern South China Sea and 844.1 million barrels of oil in the Western South China Sea that year³⁸. The CNOOC’s daily extraction amounted to 212,895 barrels per day in the eastern part and 42,870 barrels per day in the western part³⁹. Considering that China’s overall daily consumption of refined oil was 12.47 million barrels in 2016⁴⁰, an expansion of the country’s hold on natural resources in the South China Sea seems logical.

³⁷ Morton (2016) *China’s ambition in the South China Sea*, p.915.

³⁸ China National Offshore Oil Company (2017) *Key operating areas*. Available at: <http://www.cnoc ltd.com/col/col7311/index.html> (Accessed: April 29, 2019).

³⁹ Ibid.

⁴⁰ Central Intelligence Agency (2019) *China, CIA World Factbook*. Available at: <https://www.cia.gov/library/publications/the-world-factbook/geos/ch.html> (Accessed: April 29, 2019).

Lucrative reserves of natural resources in these waters are central to the economic and energy interests of China, Vietnam, and the Philippines. Bellicose behavior is a result of this interest. In 2011, a Chinese fishing boat allegedly cut cables of a Vietnamese ship looking for oil in Vietnam's EEZ. Three years later, in May 2014, Chinese vessels fired water cannons when Vietnamese ships approached a Chinese drilling platform in the vicinity of the Paracel Islands off the Vietnamese coast⁴¹. These incidents illustrate that hostilities in the South China Sea do not solely revolve around the issue of territory alone but also around the fight over natural resources.

In September 2017, the Philippines announced that it was negotiating with the CNOOC about a possible cooperation close to contested waters⁴². In November 2018, China and the Philippines



agreed to a joint oil and gas exploration project⁴³. Similar to Vietnam, the Philippines is on a collision course with China over natural resources in the South China Sea, however, the Philippines is willing to engage in a joint drilling project as China holds onto its confident demeanor in the South China Sea. The issue with such

collaboration projects is that less powerful states like the Philippines find themselves in a tough situation in which they must choose cooperation with China over engagement in order to benefit from the natural resources in the area and to calm the tense diplomatic relations. The loss of access to regional sub-sea gas and oil could prove harmful for the economies of these less powerful states.

⁴¹ Xu (2014) South China Sea tensions. (Accessed: April 22, 2019).

⁴² Dela Cruz, E. (2017) Philippines to explore for oil and gas with China near disputed waters, *Reuters*. Available at: <https://www.reuters.com/article/us-asean-philippines-energy/philippines-to-explore-for-oil-and-gas-with-china-near-disputed-waters-idUSKCN1C31NG> (Accessed: April 29, 2019).

⁴³ Rapoza, K. (2018) Oil deals may be key to peace in South China Sea, *Forbes*. Available at: <https://www.forbes.com/sites/kenrapoza/2018/11/21/oil-deals-may-be-key-to-peace-in-south-china-sea/#e6df53812050> (Accessed: April 29, 2019).

International Trade

The South China Sea is one of the world's most important trade routes, linking East Asia with India, Africa, and the Middle East. The 550 mile-long (890 kilometer-long) Strait of Malacca stretches between the coasts of Indonesia and Malaysia and connects the Indian Ocean with the Pacific Ocean (see Map 2). Therefore, it is the shortest route between the Middle East and Pacific Asia. Roughly 40,000 ships pass through the South China Sea every year⁴⁴,



transporting between 3.4 billion USD and 5.3 trillion USD worth of commodities per annum⁴⁵. An estimated 61% of the world's maritime trade has its final stop at ports in the South China Sea and 41% of global maritime trade departs from this region⁴⁶. More than half of the world's oil tankers transited the South China Sea in 2010⁴⁷, and according to data from 2019, 4 out of the 10 busiest ports in the world are located along the coasts of these waters⁴⁸. Trading traffic in the South China

⁴⁴ Morton (2016) *China's ambition in the South China Sea*, p.914.

⁴⁵ Center for Strategic and International Studies (n.d.) *How much trade transits the South China Sea*, *Center for Strategic and International Studies: ChinaPower*. Available at: <https://chinapower.csis.org/much-trade-transits-south-china-sea/> (Accessed: April 29, 2019).

⁴⁶ United Nations (2018) *Review of maritime transport 2018*, *United Nations Conference on Trade and Development*. Available at: https://unctad.org/en/PublicationsLibrary/rmt2018_en.pdf (Accessed: April 29, 2019), p.8.

⁴⁷ Rosenberg (2010) *Governing the South China Sea*, p.7.

⁴⁸ Routley, N. (2019) *Here are the 20 busiest ports on the planet*, *World Economic Forum*. Available at: <https://www.weforum.org/agenda/2019/02/visualizing-the-world-s-busiest-ports/> (Accessed: April 29, 2019).

Sea is five times higher than in the Panama Canal and three times higher than in the Suez Canal⁴⁹. The South China Sea trade route is vital because an estimated 64% of Chinese and 42% of Japanese maritime trade depend on it. To some extent, the United States also relies on this route since approximately 14% of its maritime trade transits through the South China Sea⁵⁰.

Military conflict in the South China Sea would likely have a detrimental effect on global trade and economies that rely on commodity exchange. Low safety in the region would lead to a surge in trading costs. Shipping vessels would avoid critical zones of conflict and select longer, costlier routes for more secure transfer. At the same time, the price of insurance premiums would rise due to increased risks.



Map 2: The Strait of Malacca connects Southeast Asia with the Middle East.

⁴⁹ Xu (2014) South China Sea tensions. (Accessed: April 22, 2019).

⁵⁰ Center for Strategic and International Studies (n.d.) How much trade transits the South China Sea. (Accessed: April 29, 2019).

Energy Supply in East Asia

Trade in the South China Sea is particularly pivotal for energy supply. A third of the world's unrefined oil and over half of the world's liquefied natural gas (LNG) is delivered on South China Sea routes⁵¹. East Asian countries are especially dependent on energy shipped across the South China Sea. China, Japan, and South Korea are the top three importers of crude oil traversing these contested waters. China's share of total crude oil imports passing the South China Sea amounts to 42%, Japan's imports add up to 20%, and South Korea's imports measure up to 18%⁵². Approximately 80% of China's entire crude oil imports transit these waters. Moreover, almost 60% of Japan's and Taiwan's energy and 66% of South Korea's energy cross the South China Sea⁵³. After the Fukushima Daiichi nuclear catastrophe in March 2011, Japan heavily relied on LNG imports delivered on South China Sea routes⁵⁴. In summary, armed conflict in the disputed waters would lead to devastating effects on regional energy supplies.

Long-term allies Japan and the United States focus strongly on naval activities and commercial shipping in the disputed waters. If 90% of the South China Sea would be under China's jurisdiction, trade and energy supply for regional states would be strongly limited and dictated by China. This would force them to engage in either war or in trade agreements with Beijing. The latter outcome would give the Chinese government great diplomatic and economic leverage. A case in point would be the previously exemplified cooperation of the Philippines with China to extract maritime oil resources. Powerful states such as the United States and Japan, however, would be able to exercise their strength and demand concessions from China.

⁵¹ Zhong, H., and White, M. (2017) *South China Sea: Its importance for shipping, trade, energy and fisheries, Asia-Pacific Journal of Ocean Law and Policy* 2, p.17.

⁵² U.S. Energy Information Administration (2018) *More than 30% of global maritime crude oil trade moves through South China Sea*. Available at: <https://www.eia.gov/todayinenergy/detail.php?id=36952> (Accessed April 29, 2019).

⁵³ Kaplan, R. D. (2015) *Why the South China Sea is so crucial, Business Insider Australia*. Available at: <https://www.businessinsider.com.au/why-the-south-china-sea-is-so-crucial-2015-2> (Accessed: April 29, 2019).

⁵⁴ Zhong, H., and White, M. (2017) *South China Sea*, p.18.

Trade Among ASEAN States

Trade patterns among ASEAN states have changed significantly since the 1980s. After trade was liberalized and globalized in the 1980s and 1990s, ASEAN member states increasingly exchanged goods with other Asian states, in particular with China and South Korea. During the 1980s, ASEAN's major trade partners were the United States, Europe, and Asian economic powerhouse Japan. 54.3% of all commodity transactions of ASEAN members were with these countries, but the situation changed over the years. ASEAN increased its commodities exchange with China and South Korea from 29.6% in the 1980s to 41% in 2009⁵⁵. According to data from 2015, China emerged as the top trading partner of ASEAN, followed by Japan, the European Union, the United States, and the Republic of Korea⁵⁶. Trade ties between ASEAN member states and China were forged in 2002 when eleven countries in total⁵⁷ agreed to the ASEAN-China Free Trade Area, yet economic benefits drawn from the agreement may become restricted if military conflict erupted in the South China Sea.

China's Belt and Road Initiative

President Xi Jinping commenced a strategic economic project, binding trade partners to China's area of influence with the Belt and Road Initiative (BRI) in 2013. The initiative extends international trade routes on land over the Silk Road Economic Belt and on water over the 21st Century Maritime Silk Road. Crucial waters that the BRI is contingent upon are the South China Sea and the Strait of Malacca. They are a starting point for the global trade project. Hence, the South China Sea represents a vital zone for China's economic ambitions and expansion of power. Based on benefits from international BRI trade partnerships, China will not cease to claim territory within the nine-dash line. If provoked, China is expected to engage in violent conflict over the South China Sea

⁵⁵ Rosenberg (2010) *Governing the South China Sea*, p.7.

⁵⁶ ASEAN (2016) *Top ten ASEAN trade partner countries/regions, 2015*. Available at: https://asean.org/wp-content/uploads/2016/11/Table20_as-of-6-dec-2016.pdf (Accessed: April 29, 2019).

⁵⁷ Heads of state from the following countries signed the agreement: Brunei, Cambodia, Indonesia, Laos, Malaysia, Burma, the Philippines, Singapore, Thailand, Vietnam, and China.

because pushing Chinese ships out of the waters would threaten Beijing's economic plans and power ambitions.

Impact on the Middle East

Considering that an average of 15 million barrels of oil are shipped through the South China Sea every day⁵⁸, conflict would also negatively impact oil prices and profits of Middle Eastern states that export crude oil. Above all, Saudi Arabia would be burdened by this since 24% of the entire crude oil trade in the South China Sea comes from this country. The United Arab Emirates' share of South China Sea oil trade flows is 11%. Iran, Iraq, and Kuwait contribute 8% to oil exports in this sea⁵⁹. If military conflict blocked trade routes in the South China Sea, these countries would suffer considerably. Other oil exporting countries that would be affected to a smaller degree are Angola, Qatar, Oman, Malaysia, and Singapore⁶⁰.

Conclusion

Tensions in the South China Sea are expected to rise as China adopts a more aggressive strategy. Restructuring regional order, China challenges its Southeast Asian neighbors, the U.S. and, by extension, other East Asian states and European countries. All of them have a stake in the South China Sea and defend various interests. Western powers will try to guard an international rules-based order after China defied international maritime law and continued to expand its reach in the contested waters.

⁵⁸ U.S. Energy Information Administration (2018) *30% of global maritime crude oil trade*. (Accessed April 29, 2019).

⁵⁹ U.S. Energy Information Administration (2018) *30% of global maritime crude oil trade*. (Accessed April 29, 2019).

⁶⁰ Ibid.

If Southeast Asian states would individually measure their military power with China, they would fight a losing battle due to China's defensive capacities. Two options for regional neighbors are either agreeing with China on economic and resource extraction partnerships to draw benefits from the precarious situation or joining defense alliances with like-minded states. The latter option is more likely to cause military conflict that would pull in Southeast Asian and East Asian states as well as Western countries like the United States.

Copious amounts of natural gas and oil

underneath the sea makes this region prone to strife. Several clashes between ships of oil and gas companies with other such vessels or fishing boats in the past illustrate the tangible extent of hostilities in the South China Sea. Such incidents put further strain on diplomatic relations between China and its neighbors.

Solving the conflict through military action would have detrimental effects on oil prices, economic stability, and regional energy supply. East Asian states would be cut off from vital oil and gas imports while trade among ASEAN states could also deteriorate. In addition, oil exporting countries in the Middle East would experience financial losses. If war over territory broke out in the South China Sea, international trade and the global economy are likely to suffer.





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