

# PERSPECTIVE

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## **China-Philippine Relations: Duterte's China Visit and Prospects for Oil and Gas Exploration**

*Lye Liang Fook\**

### **EXECUTIVE SUMMARY**

- Duterte took a tougher line during his recent China visit by raising the 2016 arbitral tribunal ruling; but as expected, Chinese President Xi Jinping reiterated China's position.
- Duterte was more concerned with assuaging rising domestic criticism of him for being too soft on China than with influencing China's behaviour in the South China Sea.
- There was more pomp as Duterte was feted to the FIBA Basketball World Cup, with Xi and Chinese Vice President Wang Qishan accompanying him on two separate occasions. Only six agreements were signed during his visit.
- The announcement of the formation of a joint steering committee and a working group on oil and gas exploration was of an anti-climax as both sides had already agreed to form these two bodies in late 2018.
- Details of oil and gas exploration such as the parties involved, where to collaborate and how to collaborate remain to be worked out.

*\* Lye Liang Fook is Senior Fellow and Co-coordinator of the Regional Security and Political Studies Program and Coordinator of the Vietnam Studies Programme at ISEAS – Yusof Ishak Institute.*

## INTRODUCTION

Philippine-China relations have continued with positive momentum with Philippine President Rodrigo Duterte's fifth visit to China from late August to early September 2019. China regards the visit as one that builds on the comprehensive strategic cooperation established less than a year ago. Chinese President Xi Jinping has urged Duterte to view relations from a broad standpoint in an effort to downplay recent incidents in the South China Sea involving the two countries.

The outcome of the visit, with six agreements signed, seems a bit thin especially when compared to Duterte's 2016 state visit to China when Beijing pledged US\$24 billion in investments, grants and loans, or Xi's 2018 state visit to the Philippines when 29 agreements were signed. Both countries also announced the formation of a joint steering committee and a working group on oil and gas exploration. The agreement to form these two bodies was reached in November 2018, however, and it took almost a year before they made the announcement.

At the same time, the small step taken towards oil and gas exploration may be easily overlooked for its significance. There was caution on both sides not to rush the process given the sensitivities involved as well as past experience of troubled collaboration, namely, the 2005-2008 Joint Marine Seismic Undertaking.<sup>1</sup> There is a possibility for both sides to start with oil and gas exploration in Service Contract 57 that lies within the Philippine Exclusive Economic Zone (EEZ), although details have to be worked out.

## DUTERTE'S VISITS TO CHINA

Duterte's five-day visit to China from 28 August to 1 September 2019 was at the invitation of his Chinese counterpart Xi Jinping, and with that, he has visited China five times in three years (see *Table 1* below).

**Table 1: Duterte's Visits to China**

No.	Date	Nature of Visit
1	18 – 21 Oct '16	Duterte's state visit to China
2	14 – 15 May '17	Duterte attends China's inaugural Belt and Road Forum in Beijing
3	9 – 10 Apr '18	Duterte attends the Boao Forum for Asia Annual Conference in Hainan
4	25 – 27 May '19	Duterte attends China's Second Belt and Road Forum in Beijing
5	28 Aug – 1 Sep '19	Duterte in China on his fifth visit

*Source: Compiled by author based on various public sources*

Duterte's state visit to China took place in October 2016, soon after he was sworn in as president in June 2016. This marked a turning point in bilateral relations after years of acrimonious ties under his predecessor Benigno Aquino, who oversaw an arbitration case

brought by the Philippines against China in the South China Sea. This visit, coming after the arbitral tribunal gave a ruling almost entirely in favour of the Philippines in July 2016, indicated a willingness on the part of the Philippines to put the ruling on the backburner in the interest of relations with China. Not surprisingly, Chinese media described the visit as an “ice-breaking journey” (破冰之旅) or a “journey of cooperation” (合作之旅).<sup>2</sup>

Since then, Duterte has visited China on four other occasions:

- He actively participated in President Xi’s flagship event, the Belt and Road Forum, on two separate occasions, in May 2017 and May 2019. At the inaugural forum in May 2017, Duterte introduced his administration's “Build, Build, Build” programme. In response, the Chinese side stressed the high degree of complementarity between this and the China-led Belt and Road Initiative and, by extension, the win-win outcomes if both were to work closely together.<sup>3</sup>
- In April 2018, Duterte participated at the Boao Forum for Asia Annual Conference in Hainan where he stated that the Philippines stood together with China in the fight against crime, illegal drugs, terrorism and violent extremism. He added that the two countries were partners in the building of infrastructure and strengthening economic complementarities.<sup>4</sup>
- After Hainan, Duterte travelled to Hong Kong where a highlight was his public apology to the Chinese people for the deaths of eight Hong Kong tourists killed in the 2010 bus hostage situation in Manila.<sup>5</sup> The apology, offered in his capacity as president and on behalf of the Philippine people, marked another departure from Benigno Aquino who had refused a public apology by attributing the hostage situation to the actions of an individual.<sup>6</sup>
- In his latest visit to China from August to September 2019, a highlight was the announcement by the Philippines and China of the formal establishment of a joint steering committee and a working group on oil and gas development in the South China Sea.

Duterte and Xi have met a total of eight times. Apart from Duterte’s five visits to China, the two also met at the 24<sup>th</sup> APEC Economic Leaders Meeting in Lima (Peru) in November 2016, at the 25<sup>th</sup> APEC Economic Leaders Meeting in Danang (Vietnam) in November 2017 and during Xi’s state visit to the Philippines in November 2018. In contrast, Duterte’s predecessor Benigno Aquino only visited China twice, once in 2011 for a state visit and a second time in 2014 for the 22<sup>nd</sup> APEC Economic Leaders’ Meeting. By the time of Aquino’s second visit, Philippine-China relations had reached a nadir due to the 2013 arbitral tribunal case.

Duterte’s frequent interactions with Xi stands in contrast to his interactions with leaders of the major western powers. In particular, Duterte has yet to visit the United States even though Trump had extended an invitation to him in late 2016 when Trump was still the president-elect.<sup>7</sup> Also, Duterte has yet to visit any major European country such as the United Kingdom, France and Germany.

## HIGHLIGHTS

There were several highlights in Duterte's latest visit to China. One was Duterte taking a tougher line with China on the South China Sea. Before his visit, he had vowed to raise the 2016 arbitral tribunal ruling with China regardless of Beijing's reaction.<sup>8</sup> The Philippine Presidential Spokesperson Salvador Panelo said that Duterte did indeed raise the 2016 arbitral tribunal ruling in a "friendly, assertive, unequivocal manner" with Xi. Panelo said Xi told Duterte that he was not offended by the latter raising the issue but responded by reiterating China's well-known position of non-recognition of the ruling.<sup>9</sup>

Toeing the official line, the Chinese media made no mention of the 2016 arbitral tribunal ruling. Instead, Xi was reported to have said that China and the Philippines have been maintaining "effective communication" on the South China Sea issue and that the two sides should set aside their disputes and concentrate on pursuing cooperation. Xi further said that as long as the South China Sea issue was handled properly, the "atmosphere of bilateral ties will be sound" and the "foundation of the relationship will be stable". Xi also called on both sides to take a "bigger step in joint development of offshore oil and gas".<sup>10</sup> Both sides seem to have agreed that their differences in the South China Sea are not the sum total of their relationship and ought not to prevent them from cooperating in other areas.

Another highlight was China's framing of Duterte's visit to be further building on the existing good foundation of China-Philippine relations. A prevalent narrative is that since Duterte assumed office in 2016, relations between the two countries have undergone three distinct phases, namely, turning the corner of acrimonious relations under Duterte's predecessor, to the second stage of strengthening relations, and onward to the third stage of upgrading of relations, which refers to the elevation of China-Philippine relations to comprehensive strategic cooperation during Xi's state visit to the Philippines in November 2018.<sup>11</sup> Xi further urged Duterte to guide the sound development of China-Philippine relations from a strategic and long-term perspective.<sup>12</sup>

Yet another highlight was China and the Philippines moving a step closer on joint oil and gas exploration in the South China Sea. It was announced after the Xi-Duterte meeting in Beijing that the two countries have established an intergovernmental joint steering committee and a working group on oil and gas exploration.<sup>13</sup> The joint steering committee is to be co-chaired by senior officials from the foreign ministries, with senior officials from the energy ministries/agencies as co-chair. As for the working group, it appears that the Chinese side will be represented by the state-owned China National Offshore Oil Corporation (CNOOC) while the Philippine side will likely assign a company that has an existing service contract with the government in the areas of joint exploration, but this has yet to be determined.<sup>14</sup>

To be sure, six other agreements were signed during Duterte's visit ranging from higher education cooperation, science and technology cooperation, customs matters to concessional loan and credit loan matters.<sup>15</sup> But none of these agreements garnered as much attention as the announcement of the formation of the joint steering committee and working group on oil and gas exploration. The number of agreements signed is also nowhere near the 29 agreements signed during Xi's state visit to the Philippines.<sup>16</sup>

Another noteworthy aspect was China's adept use of sports diplomacy to appeal to Duterte. Duterte's visit coincided with China's hosting of the 2019 FIBA Basketball World Cup. Duterte was apparently the only foreign head of state/government at the opening ceremony in Beijing, presided over by Xi. Thereafter, Chinese Vice President Wang Qishan, Xi's close confidant, accompanied Duterte to Guangdong to watch the opening segment of the FIBA Basketball World Cup that pitted the Philippines men's basketball team against their Italian counterparts.<sup>17</sup> It is a rare gesture for two top Chinese leaders to accompany a visiting foreign dignitary at a sports event.

In what could be regarded as another effort to appeal to the Philippine side, the ship captain of the Chinese vessel that sank a Philippine fishing boat near Reed Bank on 9 June 2019 conveyed an apology and offered compensation for the losses arising from the sinking of the boat a day before Duterte's China visit. This was conveyed through the Guangdong Provincial Fishery Mutual Insurance Association President Chen Shiqin on behalf of the ship captain who is purportedly a member of the association.<sup>18</sup>

## **OUTCOMES**

Duterte's raising of the 2016 arbitral tribunal ruling seemed to be driven more by the need to assuage his domestic critics back home. It would not have been lost on China that this was more a tactical move than one that was really aimed at influencing China's behaviour in the South China Sea. In fact, after raising the 2016 arbitral tribunal ruling, Philippine Presidential Spokesperson Salvador Panelo reportedly said that Duterte would no longer be raising this matter in future meetings with Xi.<sup>19</sup> Duterte himself, upon his return from China, implicitly admitted the limited impact of his effort when he said that although he had told Xi that he was not satisfied with the latter's answer, he would not insist on getting any other answer. Duterte added that he has so far not heard any "sane" suggestion on how to resolve the differences with China short of war.<sup>20</sup> This "short of war" refrain has been used before by Duterte to make the point that the Philippines is unable to influence China's behaviour.

Another expected outcome was China's continued support for Duterte's "Build, Build, Build" programme unveiled in 2017 and estimated to cost 8 trillion Philippine pesos (about US\$150 billion). In particular, China and the Philippines signed a US\$220 million preferential buyer's credit loan agreement to fund the project management consultancy of the Philippine National Railways (PNR) South Long Haul Project, an ambitious 639-kilometre railway costing an estimated US\$3.3 billion that will link Metro Manila to Matnog municipality in the south.<sup>21</sup> More than two years after the "Build, Build, Build" programme was announced, the PNR South Long Haul Project is still at the project management consultancy stage and has yet to progress to the awarding of construction packages.<sup>22</sup>

This has reinforced the perception of the slow implementation pace of Chinese projects and that what China has actually committed to is a small fraction of the US\$24 billion pledged during Duterte's state visit to China in October 2016. Reasons cited for this include Duterte being in a weak bargaining position vis-à-vis China (as he tilted towards China before securing reciprocal commitments from China); Chinese lenders' increasing reluctance to commit to funding due to the many questionable infrastructure loans already on their books;<sup>23</sup> and the Philippines being more cautious about accepting loans from China due to

fears of being saddled with debts and over security concerns, or simply due to lack of skilled Philippine workers.<sup>24</sup>

On joint oil and gas exploration, China and the Philippines have taken a further step with the announcement of the formation of an intergovernmental joint steering committee and working group on oil and gas cooperation. This announcement is not a dramatic development since in the MOU on Cooperation on Oil and Gas Development signed during Xi's state visit to the Philippines in November 2018, it was already agreed that the two governments would establish an intergovernmental joint steering committee and one or more working groups.<sup>25</sup> What is now clear is that instead of one or more working groups, only one working group has been formed.

Although this is a small step, it is of some significance in view of the groundwork that has been laid by the two countries. In particular, in May 2018, Duterte issued Executive Order No. 80 that allows the Philippine National Oil Company Exploration Corporation (PNOC EC), the upstream arm of state-owned Philippine National Oil Company, to enter into farm-in/farm-out agreements through which: (a) third parties can participate in service contracts awarded by the Philippine government to PNOC EC; and, (b) PNOC EC can participate in service contracts awarded by the Philippine government to third parties.<sup>26</sup>

Executive Order No. 80 effectively repeals Executive Order No. 556 (issued by President Gloria Arroyo in 2006) that forbids "farm-in" or "farm-out" contracts by any government agency including PNOC and requires all government agencies to follow a "strict bidding procedure in forging partnerships with interested parties" (*including with Chinese companies, italics are author's own addition*).<sup>27</sup> Executive Order No. 80 therefore makes it easier for PNOC to enter into service contracts with Chinese companies for oil and gas in the South China Sea. More specifically, there is a view that PNOC-EC can move ahead on Service Contract (SC) 57 with China National Offshore Oil Corporation (CNOOC) in the Calamian, located to the northwest of Palawan Island.

PNOC-EC was awarded SC 57 in 2005 and a year later, CNOOC and Mitra Energy (today known as Jadestone Energy) farmed-in into the contract.<sup>28</sup> The formalization of the foreign companies' entry required the approval of the President of the Philippines but this did not happen because of Executive Order No. 556 that came into force in 2006. Following Executive Order No. 80, SC 57, spanning an area of 7,200 square kilometres, could be revisited with the original set of partners. This area falls within the Philippine EEZ and outside China's nine-dash line map. At the moment, the Chinese side seems amenable to a 60-40 profit sharing arrangement in favour of the Philippines. However, details such as how the Philippine state is to exercise full control and supervision over the exploration, development and utilization of natural resources in an area that falls under its sovereign jurisdiction remains to be worked out. Some observers have opined that if an agreement can be reached, it could build confidence for China and the Philippines to work together on other more sensitive areas.

Another possible area for oil and gas exploration is SC 72, covering 8,800 square kilometres, located to the west of Palawan Island. This is a more sensitive area disputed over by both the Philippines and China.<sup>29</sup> The governments of the two countries will need to conclude an agreement/treaty before they move to the next stage of awarding service contracts in favour of the designated companies of the contracting parties. However,

arriving at an agreement will take a long time as both sides will want to ensure that the wording used does not undermine the legality of their respective sovereignty claims. In addition, Duterte can be expected to face greater domestic criticism, even opposition, to his collaborating with China in a disputed area.

## CONCLUSION

The atmospherics of Duterte's fifth visit to China were dampened somewhat by China's actions in the South China Sea including the sending of hundreds of fishing vessels to swarm Thitu Island and the sinking of a Philippine fishing vessel near Reed Bank in the first half of this year. This would explain why Duterte decided to raise the 2016 arbitral tribunal ruling when he met Xi in Beijing. The Chinese side seemed to understand Duterte's standpoint and urged him to look at relations from a longer term strategic perspective. Xi also called for a "bigger step" in joint oil and gas exploration. Both countries did make some progress with the announcement of the formation of a joint steering committee and a working group on oil and gas exploration. Although this may not be a big step, it shows that the two countries are proceeding cautiously. It remains to be seen what kind of a deal both countries can strike.

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<sup>1</sup> There is a current case before the Philippine Supreme Court (SC) filed in 2008 that calls on the SC to nullify the three-country Joint Marine Seismic Undertaking (JMSU) for allegedly violating the Philippine Constitution. See "Bayan Muna to SC: Resolve 10-yr-old joint exploration deal in WPS", *Philippine Daily Inquirer*, 21 November 2018.

<sup>2</sup> "Zhongfei kuahai woshou, kaiqi pobing zhilu" (China and Philippines cross the seas to shake hands, open up ice-breaking journey), Sohu, 16 November 2016.

<sup>3</sup> "Zhongfei gongying: 'yidai yilu' duijie 'dajian te jian'" (China-Philippine win-win cooperation: 'One Belt One Road' complements 'Build, Build, Build' programme), *Guangming Ribao*, 29 July 2019.

<sup>4</sup> "Full text: Speech by Philippine president Duterte at Boao Forum", *China Daily*, 17 April 2018.

<sup>5</sup> "Philippine President Duterte apologises for 2010 Manila hostage tragedy", SCMP video, available at <https://www.scmp.com/video/asia/2141577/philippine-president-duterte-apologises-2010-manila-hostage-tragedy>.

<sup>6</sup> "Feilubin zongtong Dute Erte jiu Xianggang renzhi shijian zhengshi xiang Zhongguo daoqian" (Philippine President Duterte issues formal apology to China on Hong Kong hostage incident), *China Daily*, 13 April 2018.

<sup>7</sup> "Donald Trump Invites Philippines' Rodrigo Duterte to the White House After 'Animated' Phone Call", *Time*, 2 December 2016. Duterte has so far had only one bilateral meeting with Trump on the sidelines of the 31st ASEAN Summit and Related Meetings in Manila in November 2017.

<sup>8</sup> "China can't stop me from raising The Hague ruling – Duterte", *Manila Bulletin*, 24 August 2019.

<sup>9</sup> "Press Briefing of Presidential Spokesperson and Chief Presidential Legal Counsel Secretary Salvador Panelo", Presidential Communications Operations Office, 30 August 2019.

<sup>10</sup> "Xi Jinping huijian Feilubin zongtong Dute Erte" (Xi Jinping meets with Philippine President Duterte), Xinhuanet, 29 August 2019.

<sup>11</sup> “Qianzhan Duterte Erte fanghua: Zhongfei guanxi ‘sanbuqu’ hou liangguo zai kaipi xin weilai” (Looking ahead to Duterte’s China visit: China-Philippine relations after ‘three stages’, the two countries open up new horizons), Chinanews.com, 26 August 2019. The stage of comprehensive strategic cooperation is a notch higher than the “strategic and cooperative relations” established during Chinese President Hu Jintao’s state visit to the Philippines in April 2005.

<sup>12</sup> “Xi Jinping huijian Feilubin zongtong Duterte” (Xi Jinping meets with Philippine President Duterte), Xinhuanet, 29 August 2019.

<sup>13</sup> “China, the Philippines set up joint steering committee on oil, gas cooperation”, Xinhuanet, 29 August 2019.

<sup>14</sup> It was reported that the Chinese side would comprise seven members led by Vice Foreign Minister Luo Zhaohui as co-chair and Vice Minister Li Fanrong of the National Energy Administration (the energy agency under China’s National Development and Reform Commission) as co-vice chair. There will be three others from China’s foreign ministry, one from the Communist Party of China Central Committee, and one from the National Energy Administration. The Philippine side will reportedly have eight officials – the co-chair and co-vice chair plus three other members from the Department of Foreign Affairs, and one each from the Department of Energy, Department of Justice and the National Mapping and Resource Information Authority. See “Exclusive: PH, China appoint members of joint exploration committee”, *CNN Philippines*, 30 August 2019 (news article carried by the Philippine Department of Energy at <https://www.doe.gov.ph/energist/exclusive-ph-china-appoint-members-joint-exploration-committee>).

<sup>15</sup> The six agreements signed were: (a) Memorandum of Understanding on higher education cooperation between the Commission on Higher Education of the Philippines and the Ministry of Education of China; (b) MOU on science and technology cooperation between the Department of Science and Technology of the Philippines and the Ministry of Science and Technology of China; (c) Cooperative arrangement between the Bureau of Customs of the Department of Finance of the Philippines and the General Administration of Customs of China on the implementation of the intergovernmental agreement regarding cooperation and mutual assistance in customs matters; (d) Implementation contract on the project of China-aid container inspection equipment between the Customs bureau and the Chinese Ministry of Commerce; (e) Exchange of notes on cooperation procedure for the availment and utilization of concessional loan under a Renminbi-denominated loan facility between the finance department and China International Development Cooperation Agency; and, (f) Preferential buyer’s credit loan agreement of project management consultancy of the Philippine National Railways South Long Haul Project between the finance department and the Export-Import Bank of China. See “Six deals signed after bilateral talks between Duterte and Xi”, *Philstar*, 29 August 2019.

<sup>16</sup> “Full Text of China-Philippines joint statement”, Xinhuanet, 21 November 2018.

<sup>17</sup> “Lanqiu cheng Duterte Erte fanghua yida kandian, bannian liangci laihua you neixie zhongyao yiti?” (Basketball becomes a key highlight of Duterte’s China visit, what are the important issues for two visits to China in half a year), ifeng.com, 29 August 2019.

<sup>18</sup> The Philippine Department of Foreign Affairs (DFA) released on 28 August 2019 a memorandum from Guangdong Provincial Fishery Mutual Insurance Association President Chen Shiqin titled “Chinese Apology on the Recto Bank Collision Incident” which carried the apology of the Chinese ship captain. See “Chinese apology for Philippine fishing boat sinking lands as Rodrigo Duterte heads to Beijing”, *SCMP*, 28 August 2019.

<sup>19</sup> “Duterte won’t raise Hague ruling again, says Palace”, *Philippine Daily Inquirer*, 31 August 2019.

<sup>20</sup> See news conference by Duterte titled “Philippine President Duterte admits being at a loss getting Beijing to honour South China Sea ruling”, Youtube, 6 September 2019, available at <https://www.youtube.com/watch?v=cigI01LMt2k>.

<sup>21</sup> The PNR South Long Haul Project is among the 75 infrastructure flagship projects under Duterte’s “Build, Build, Build” programme.

- <sup>22</sup> The award of the construction packages is expected to start by fourth quarter 2019.
- <sup>23</sup> “The Philippines’ pivot toward China has yet to pay off, as Manila awaits promised funds”, *CNBC*, 23 November 2018.
- <sup>24</sup> “Duterte: Labor gap delaying ‘Build, Build, Build’”, *Philstar*, 15 February 2019. See also “A creeping Chinese ‘invasion’”, *Philstar*, 27 March 2018.
- <sup>25</sup> “Memorandum of Understanding on Cooperation on Oil and Gas Development between the Government of the People's Republic of China and the Government of the Republic of the Philippines”, China’s foreign ministry, 27 November 2018.
- <sup>26</sup> Farm-in/farm-out refers to a practice, recognised and accepted in the oil and gas industry, of allowing third party participation to spread the risks inherent in oil and gas exploration, development and production. The entity acquiring the participating interest considers the transaction as a “farm-in”, while the entity transferring such interest considers the transaction as a “farm-out”. See Executive Order No. 80, By The President of the Philippines, 28 May 2019.
- <sup>27</sup> Executive Order No. 556, By The President of the Philippines, 17 June 2006.
- <sup>28</sup> In this joint venture, CNOOC held more 51 percent of the shares, followed by PNOC-EC at 28 percent and Mitra Energy at 21 percent. See “Service Contract No. 57 – Calamian”, PNOC EC, as of May 2018, available at <https://pnoc-ec.com.ph/service-contract-no-57-calamian-2/>.
- <sup>29</sup> Oil and gas exploration work in this area was suspended in December 2014 due to the case before the arbitral tribunal lodged by the Philippines against China. Philex Petroleum holds a 60.49 per cent interest in Forum Energy – which operates SC 72 in Reed Bank (also known as Recto Bank). In turn Forum Energy has a 70 per cent in SC 72. See “PHL stops oil and gas drilling in Reed Bank, cites dispute with China”, *GMA News*, 3 March 2015.

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