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**ECONOMIC INTERDEPENDENCE AND SECURITY IN  
SOUTHEAST ASIA: A REALIST ANALYSIS**

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## DECLARATION

I hereby declare that this master's thesis titled as "ECONOMIC INTERDEPENDENCE AND SECURITY IN SOUTHEAST ASIA: A REALIST ANALYSIS" has been written by myself in accordance with the academic rules and ethical conduct. I also declare that all materials benefited in this thesis consist of the mentioned sources in the reference list. I verify all these with my honor.

Date

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## **ABSTRACT**

### **Master's Thesis**

#### **Economic Interdependence and Security in Southeast Asia: A Realist Analysis**

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**Graduate School of Social Sciences**

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China has increasingly integrated with the international economy by implementing liberal economic reforms. As a result, the country has made huge progress in economic development to become the world's second largest economy. The effects of the economic rise of China on economic advancement and power politics in Asia Pacific is a remarkable topic in contemporary international relations. These effects started with China's financial support to its Southeast Asian neighbors during the Asian financial crisis of 1997. With China's help, Southeast Asian countries have experienced economic recovery and trade and investment flow has increased dramatically. They have also benefited from the opportunities provided by China for the maintenance of their economic growth. Specifically, the Philippines and Vietnam have proven themselves willing to take advantage of China's economic rise to contribute to their economic development. Therefore, they have sought through numerous channels to strengthen their economic cooperation with China. This cooperation has led to broadened access to markets, raw materials, energy resources and intermediate products. In exchange, they receive financial support and privileges such as low tariffs. As a result, while developing their economic relations with China, they have enjoyed significantly expanding trade volumes. These developments have paved the way for increasing interdependence among

their economies. The question of whether these economic relations have an effect on their security relations is increasingly important.

This study examines the impact of economic interdependence between China-the Philippines, and China-Vietnam in terms of their security policies in the context of the South China Sea dispute from the realist perspective of international relations. First, the study postulates that there is undeniable economic interdependence between aforesaid states, and that the Philippines and Vietnam are in economically vulnerable positions. Second, this study objects to Neoliberal claims that economic interdependence leads to peaceful relations among states because of the high cost of conflict. Contradicting these Neoliberal assumptions, this study argues that states have little tolerance in terms of security issues, and are encouraged to take necessary actions against external threats. Security issues and policies are significant for a state, since they are connected with the state's survival and territorial integrity. In this framework, this study describes how the Philippines, and Vietnam have responded to Chinese aggressiveness without considerations of economic loss. In addition, there is no evidence that economic interdependence or vulnerability have prevented the Philippines and Vietnam from behaving contrary to Chinese interests in the South China Sea dispute.

**Keywords:** Economic Interdependence, Security, China, China's Economic Rise, the Southeast Asia, the South China Sea dispute

## **ÖZET**

**Yüksek Lisans Tezi**

**Güneydoğu Asya’ da Ekonomik Bağımlılık ve Güvenlik: Realist bir Analiz**

**Pelin Emlik**

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Çin uyguladığı liberal reformlar sonucunda uluslararası ekonomiye entegre oldu. Bunun bir sonucu olarak önemli bir ekonomik gelişmeye imza attı ve dünyanın en büyük ikinci ekonomisi haline geldi. Böylece, Çin’in ekonomik yükselişi Asya-Pasifik’in ekonomik ilerlemesini ve güç diplomasisini ne yönde etkileyeceği günümüz uluslararası ilişkilerinde önemli bir konu haline geldi. Bu etki Çin’in 1997 Asya Ekonomik Krizi boyunca güneydoğu asyadaki komşularına finansal destek sağlamasıyla başladı. Çin’in yardımları ile bölge ekonomisi canlanmaya başladı ve ticaret ile yatırım akışında ciddi bir artış yaşandı. Güneydoğu Asya ülkeleri özellikle de Filipinler ve Vietnam ekonomik büyümelerinin devamlılığını sağlamak adına, Çin’in sağladığı ekonomik fırsatlardan faydalandılar. Bu yüzden, Çin ile ekonomik ilişkilerini bir çok farklı yönde geliştirdiler. Bu iki ülke Çin’e pazar, hammadde, enerji kaynakları ve ara ürün sağlarken karşılığında finansal destek ve ticarete düşük tarife gibi ayrıcalıklar elde ettiler. Çin ile gelişen ekonomik ilişkileri sonucunda ticaret hacimlerini önemli ölçüde artırdılar. Tüm bu gelişmeler sözü geçen ülkelerin ekonomileri arasında karşılıklı bağımlılığın artmasına yol açtı. Bu noktada, gelişmiş ekonomik ilişkilerin, güvenlik ilişkilerini nasıl etkilediği sorusunu sormak önemli hale gelmiştir.

Bu çalışma, Çin-Filipinler ve Çin-Vietnam arasındaki ekonomik karşılıklı bağımlılığın, Güney Çin Denizi anlaşmazlığındaki güvenlik politikaları üzerinde realist uluslararası ilişkiler perspektifinden nasıl etkilendiğini incelemeyi amaçlamaktadır. Birincisi, bu çalışma yukarıda bahsedilen ülkeler arasında inkar edilemez bir ekonomik karşılıklı bağımlılık olduğunu ve Filipinler ile Vietnam'ın ekonomik olarak kırılgan bir konumda olduğunu iddia etmektedir. İkincisi, bu çalışma, ekonomik dayanışmanın yüksek çatışma maliyeti nedeniyle devletler arasında barışçıl ilişkilere yol açacağı yönündeki neoliberal iddia karşı çıkmaktadır. Neoliberal varsayımdan farklı olarak, bu çalışma, güvenlik meseleleri söz konusu olduğunda devletlerin güvenlik tehditlerini tolere edemeyeceğini belirtmektedir. Devletler, güvenlik sorunları ve politikalarını, devletin hayatta kalması ve toprak bütünlüğü ile bağlantılı olduğu için çok önemli olarak görmektedir. Bu çerçevede, bu çalışma Filipinler ve Vietnam'ın Çin'in saldırganlığına hiçbir ekonomik kayıp gözetmeden nasıl karşılık verdiğini ortaya koymaktadır. Buna ek olarak, bu çalışma ekonomik karşılıklı bağımlılık veya kırılganlığa sahip olmanın, Filipinler ve Vietnam'ın Güney Çin Denizi anlaşmazlığında Çin menfaatlerine ters davranmasını engellediğine dair bir kanıt olmadığını savunmaktadır.

**Anahtar Kelimeler:** Ekonomik bağımlılık, Güvenlik, Çin, Çin'in Ekonomik Yükselişi, Güneydoğu Asya, Güney Çin Denizi Uyuşmazlığı

**ECONOMIC INTERDEPENDENCE AND SECURITY IN THE SOUTHEAST  
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## ABBREVIATIONS

<b>ACFTA</b>	ASEAN-China Comprehensive Economic Cooperation Agreement
<b>AFP</b>	Armed Forces of the Philippines
<b>ASEAN</b>	Association of Southeast Asian Nations
<b>ASEAN+3</b>	ASEAN countries and China, Japan, South Korea
<b>AIIB</b>	Asian Investment and Infrastructure Bank
<b>BP</b>	British Petroleum
<b>CMI</b>	Chiang Mai Initiative
<b>CMIM</b>	Chiang Mai Initiative Multilateralization
<b>DIA</b>	US Defense Intelligence Agency
<b>Ed.(s)</b>	Editor(s)
<b>EU</b>	European Union
<b>et al.</b>	and others
<b>CAFTA</b>	China-ASEAN Free Trade Area
<b>CCP</b>	Chinese Communist Party
<b>EEZ</b>	Exclusive Economic Zone
<b>EMEAP</b>	Executives' Meeting of East Asia-Pacific Central Banks
<b>FDI</b>	Foreign Direct Investment
<b>FTA</b>	Free Trade Agreement
<b>GDP</b>	Gross Domestic Product
<b>HYSY</b>	Hai Yang Shi You
<b>IEA</b>	International Energy Agency
<b>IMF</b>	International Monetary Fund
<b>JMSU</b>	Joint Marine Seismic Undertaking
<b>NAFTA</b>	North American Free Trade Agreement
<b>OECD</b>	Organization for Economic Co-operation and Development
<b>p.</b>	Page
<b>PCG</b>	Philippine Coast Guard
<b>PLA</b>	Peoples' of Liberation Army
<b>PLAN</b>	Peoples' of Liberation Army Navy
<b>pp.</b>	Pages
<b>RCEP</b>	Regional Comprehensive Economic Partnership

**TPP** Trans Pacific Partnership

**UN** United Nations

**UNCLOS** United Nations Convention on the Law of the Sea

**UNCTAD** United Nations Conference on Trade and Development

**US** United States

**Vol.** Volume

**WTO** World Trade Organization



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## INTRODUCTION

How and under which conditions states cooperate are prominent considerations in international relations. As the leading representation of IR theories, the opposing ideas of realists and liberals have often been affirmed. According to the liberals (and their extensions, Neoliberals) economic advancement is one of the main goals of states. Furthermore, states aim to develop their trade and investment relations to increase their wealth, and obtain a double-digit economic growth rate. They thus try to improve their economic ties with other economies. Nevertheless, economic interdependence among states can also become costly to break, while increased economic ties might put some states in a vulnerable position. Faced with this dilemma, states may either choose to reap their fruitful economic relations, or seek different policies to mitigate the negative effects of such vulnerability.

According to realists, however, security issues and policies are significant for a state since they are connected to the state's survival and territorial integrity. States are always intolerable in the context of security issues. Thus, the more states economies are connected, the more challenging it becomes for them to maintain smooth relations in the security realm. Are classic debates among realists and liberals on economy and security relations meaningful in the light of recent developments? Starting from this general question, this study examines the relations between China and Southeast Asian countries on trade issues and the South China Sea issue. At this point, questions such as the conditions under which states have economic interdependence, and how vulnerabilities affect their security policies have become significant, especially against the backdrop of contemporary international relations in the Asia Pacific region, China's economic rise, and its relations with Southeast Asian neighbors.

China's economic transformation and rapid economic growth has made it an important economic power of Asia. After accession to the World Trade Organization (WTO) in 2001, China deepened its economic relations with its neighbors. The country has become the largest trading partner of nearly every state in Southeast Asia and an important source of foreign investment. Intertwinement of economies in Asia is supported by many bilateral and regional Free Trade Agreements (FTAs). These economic agreements have further increased economic interdependence between

China and Southeast Asian countries. Liberals inspired by this economic growth believe that such development is a viable alternate to a military strategy. According to interdependency theory, trade and complex economic relations may lead peaceful relations among states because of the increasingly high cost of conflict.<sup>1</sup> Liberals thus assume that states become more interdependent economically, they are less likely to experience conflict. Keohane and Nye claim that if states have complex interdependence, they have many channels to contact, while the use of military force for solving problems is not an option.<sup>2</sup>

However, China's increasing economic power has also increased its military capabilities. Having both economic and military power led China to use them to achieve its strategic goals and increase its influence over its neighbors in the region specifically in the South China Sea. The South China Sea, surrounded by Southeast Asian countries namely, China, Vietnam, the Philippines, Malaysia, Taiwan and Brunei, is important in many respects. These countries have overlapping territorial claims over the Sea. The basis of the issue is mostly related to the strategic and economic importance of the sea for the surrounding countries.

The South China Sea is a semi-enclosed sea which is located at the intersection point of Western Pacific and Indian Ocean.<sup>3</sup> It compasses an area of about 1.4 million square miles and stretches from the Strait of Taiwan to the Strait of Malacca.<sup>4</sup> There are several islands, rocks, reefs, shoals and other features situated in the Sea. The most important islands include the Paracel Islands, the Spratly Islands, and the Scarborough Shoal.<sup>5</sup> The South China Sea's geopolitical importance lies in its huge economic, military and strategic potential. Firstly, it has enormous amount of discovered and also undiscovered energy resources including oil and natural gas. The estimated oil reserve of the region is around 11 billion barrels in total and natural

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<sup>1</sup> This study frequently using the term "conflict" and it refers to the condition that two states are actively engaged in the threat of war.

Shiping Tang, "The Security Dilemma: A Conceptual Analysis", **Security Studies**, Vol.18, No.3, 2009, p.598.

<sup>2</sup> Robert O. Keohane and Joseph S. Nye, **Power and Interdependence**, Fourth Edition, Pearson Education, New York, 2011, p.8.

<sup>3</sup> Enrico Fels and Truong-Minh Vu, "Introduction: Understanding the Importance of the Disputes in the South China Sea", **Power Politics in Asia's Contested Waters**, (Ed. Enrico Fels and Truong-Minh Vu), Springer, Switzerland, 2016, p.9.

<sup>4</sup> Fels and Vu, p.10.

<sup>5</sup> Lanteigne, p.112.



gas reserves are 190 trillion cubic feet, according to a U.S. Energy Information Administration report from 2013.<sup>6</sup>

Second, the South China Sea is a rich fishery resource, with a long fishing tradition.<sup>7</sup> For a relatively small area, the South China Sea delivers a great amount of fish. In 2012, 12% of the world's total fishing catch came from this region.<sup>8</sup> The area hosts at least 3,365 known species of marine fishes which plays important role in Southeast Asians' lives.<sup>9</sup>

Third, the South China Sea has strategic significance. It is the second-most used sealane in the world, connecting the Indian Ocean with Chinese, Japanese, Korean and Russian ports with the Malacca Strait.<sup>10</sup> This feature of South China Sea means that a huge amount of global oil and natural gas is shipped through its waters so that it has a contribution to energy trade. Also, the growing importance of naval strength necessitates control of the waters for geopolitical interests.

The significance of South China Sea caused aggressive Chinese behaviors. There are several reasons for China to be aggressive in the contested waters, all of which will be explained later in detail. However, the most remarkable reason is that the South China Sea is also strategically important for China for the continuation of the country's economic development, with its rich energy resources and important role in China's territorial integrity.

Therefore, China used low-intensity coercion to maintain its existence and control in the Sea. According to realists, when states are insecure, they take any kind of necessary actions, including military action. However, China has attempted to follow a different path due to its ongoing dilemma. On the one hand, the country is emplacing its sovereignty over the area through other methods to clinch its power, while on the other hand, it must avoid radical moves to maintain its economic development through the economic interactions with its Southeast Asian neighbors. Nevertheless, countries such as the Philippines and Vietnam have not welcomed Chinese coercion due to security concerns. Both countries upgraded their militaries for internal balancing purposes and have sought alliances for external balancing

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<sup>6</sup> Fels and Vu, p.12.

<sup>7</sup> Lanteigne, p.115.

<sup>8</sup> Lanteigne, p.116.

<sup>9</sup> Lanteigne, p.117.

<sup>10</sup> Lanteigne, p.122.

purposes. In the South China Sea case, all claimant countries have attempted to justify their aggressive behavior over the disputed area based on sovereignty concerns. Therefore, the dispute is one of the hotly-debated topics in international relations today. As Gregory B. Poling states, “the South China Sea is the site of one of the globe’s most contentious, and probably its most complicated, sovereignty disputes.”<sup>11</sup>

This study aims to determine whether economic interdependence has influenced the security policies of the Southeast Asian countries toward China in the South China Sea dispute. Economic interdependence is the independent variable of this study and in general, the term *interdependence* is used for defining the situation in the world politics in which all states are dependent on each other. Economists such as Marina v. N. Whitman have defined the phrase as referring to the sensitivity of economic behavior in one country to developments or policies originating outside its own borders.”<sup>12</sup> This study uses the definition of Keohane and Nye that “economic interdependence is an economic relationship that is costly to break”.

There are some difficulties in the measurement of economic interdependence between China and its neighbors. First, there is a need for studies focusing on the bilateral economic relations of China and its neighbors for significant theoretical and statistical reasons. Recent studies have demonstrated numerical economic findings based on averages of many Southeast Asian countries and focus less on the economic relations of China with a particular neighbor. Second, in current literature it is difficult to find studies cover time frames which contain recent dramatic international economic changes of China. In the measurement of the extent of the dependence of these countries, this study employs the indicators used by Waltz and Hirschman which are namely, trade, foreign direct investment and financial cooperation.

Security relations and policies form the dependent variable of this study. Definitions of security abound in the literature.<sup>13</sup> For instance, Hans Kelsen in his

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<sup>11</sup> Gregory B. Poling, “The South China Sea in focus: Clarifying the limits of maritime dispute”, **The Centre for Strategic and International Studies**, 2013, p.1.

<sup>12</sup> David A. Baldwin, “Interdependence and Power: A Conceptual Analysis”, **International Organization**, Vol. 34, No. 4, 1980, p.477.

<sup>13</sup> Bary Buzan’s definition of security: “Security is taken to be about the pursuit of freedom from threat and the ability of states and societies to maintain their independent identity and their functional integrity against forces of change, which they see as hostile. The bottom line of security is survival, but it also reasonably includes a substantial range of concerns about the conditions of existence. Quite

study Collective Security under International Law (1957), defined security as “the protection of men against the use of force by other men”.<sup>14</sup> His definition is inherently linked to national security and refers to national survival and physical protection of the state territory. This study has adopted Walt’s definition of security, that is “the security of the state and place particular emphasis on the preservation of the state’s territorial integrity and the physical safety of its inhabitants”.<sup>15</sup>

This study’s focus on the Philippines and Vietnam calls for explanation. To narrow down the scope of the study, some certain criteria were decisive to divide Southeast Asian countries<sup>16</sup> into categories. Only countries which fulfill both criteria have been selected as case studies.

**Table 1: Case Study Selection**

	<b>Facing with Chinese agression in the SCS</b>	<b>Not Facing with Chinese agression in the SCS</b>
<b>Has claim over Spratly Islands</b>	Philippines, Vietnam, Taiwan	
<b>Has no claim over Spratly Islands</b>		Singapore, Thailand, Laos, Cambodia, Indonesia Brunei*, Malaysia* <sup>17</sup>

The first category consists of countries which have a claim over the Spratly Islands. The second consists of countries facing with Chinese aggression in the South

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where this range of concerns ceases to merit the urgency of the “security” label (which identifies threats as significant enough to warrant emergency action and exceptional measures including the use of force) and becomes part of everyday uncertainties of life is one of the difficulties of the concept’ Barry Buzan,” New Patterns of Global Security in the Twenty-first Century” **International Affairs**, Vol.67, No.3, 1991, pp. 432-433.

Morgenthau’s definition of security: ‘Integrity of the national territory and its institutions’, in Morgenthau, Hans J. Morgenthau, **Politics Among Nations. The Struggle for Power and Peace**, 3rd edition (New York: Alfred A. Knopf, 1960)

<sup>14</sup> Hans Kelsen, **Collective Security under International Law**, Washington DC: United States Government Printing Office, 1957, p. 1

<sup>15</sup> Stephan M. Walt, “The Renaissance of Security Studies”, **International Studies Quarterly**, Vol.35, No.2, 1991, p.221.

<sup>16</sup> This study often uses “Southeast Asian countries” in reference to ASEAN countries which are namely, Singapore, Thailand, Laos, Cambodia, Indonesia Brunei, Malaysia, Philippines, Vietnam and Taiwan.

<sup>17</sup> \* This study will assume Malaysia and Brunei has no claims over the Spratly Islands. The countries have claims on the territorial waters in the South China Sea and in the Exclusive Economic Zones (EEZ) but there is no official declarations about their claims on the Islands.

China Sea. Both categories include Vietnam, the Philippines and Taiwan. Among the claimant states of the South China Sea, Malaysia and Brunei have claims only on the territorial waters and Exclusive Economic Zones (EEZ). Therefore, they are not facing with Chinese aggression and they cannot fulfill the case selection criteria of the this study. Southeast Asian countries including Singapore, Thailand, Laos, Cambodia, Indonesia Brunei, and Malaysia have no claims over Spratly Islands and not facing with forceful behaviors of China. Accordingly, they fall outside of the scope of this study.

Although located in Southeast Asia, Taiwan proves an exceptional case, and is ultimately unsuitable for the purpose in this study for several reasons. Even though it is integrated with Southeast Asia socially and economically, the country is isolated diplomatically. Taiwan's independence is not recognized by most of the countries in the world and China considers Taiwan as an internal issue under its "One China" policy. Taiwan has claims over the Spratly Islands and is in an ongoing dispute with China over the South China Sea. However, Taiwan's independence issue is an initial variable which may affect the main variables of the study. To prevent collinearity, the country has not been selected as a case of this study despite taking place both in the first and second category. Consequently, research question only includes Vietnam and the Philippines.

The outline of this study is as follows. The first chapter concentrates on the theoretical framework and literature review, including theories of international relations on economic interdependence. It also explores the concept security and the use of conflict in IR literature. The two mainstream theories of international relations, realism and liberalism, are contradictory on spillover effects of economic interdependence on security issues. Classical liberals support the idea that an increase in economic interactions among states decreases the interstate hostilities. Barry Buzan points out that "a liberal economic order makes a substantial and positive contribution to the maintenance of international security". Classical liberals unconditionally state that the more states become interdependent, the less likely they will not get into conflict with one another.

Economic liberalism goes a step further and claim that when states become economically linked, they are less likely to solve interstate problems through use of

force. Scholars who are supporters of this idea explain this argument in terms of the opportunity cost consideration. According to Smith, trade policies of states are motivated by their self-interests which brings peaceful relations as the cost of conflict is increases. The Neoliberal scholars Keohane and Nye similarly believe that complex interdependence broaden channels of contacts between states. This indicates that the use of military force is less likely or even impossible to use to solve problems.

The favorable outlook of liberals on economic interdependence is not shared by realist theorists. Realist theories emphasize that interdependence leads to results which differ from those which liberals anticipate. Kenneth Waltz claims that one state's dependence on the other can be more than the dependence on the latter to the former.<sup>18</sup> This condition may increase the hostility of the less-dependent state towards more-dependent states. Therefore, realists in general support the idea that interdependence brings conflict.

The second chapter details the economic relations of China and the Philippines and Vietnam between 2000 and 2017. Parallel to the independent variable of the hypothesis of this study, the second chapter aims to put forth the extent of economic interdependence between parties by using certain indicators. Prior to examining the degrees of economic interdependence, first section of second chapter highlights China's economic rise and its historical background, starting from efforts towards liberalizing its economy in 1980s. Contrary to popular belief, China's rise has not been smooth, as the country was following different economic model and Chinese economy was a centrally planned economy and was thus isolated and weak in 1950s and 1960s during the Mao era. During those decades, the country also experienced serious economic crises due to socio-political and economic events such as the Great Leap Forward and the Cultural Revolution. These events devastated China at the national level.

Nevertheless, by 1980, Deng Xiaoping came to the power and rebuilt the Chinese economy. The reformist leader began to apply liberal economic policies, open its economy to the global markets and implementing economic reforms. After these developments, in the 1990s China started to replace economic leadership of

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<sup>18</sup> Kenneth Waltz, **Theory of International Politics**, Addison-Wesley Publishing, the United States of America, 1979, pp.106-111.

Japan in Asia. Chinese economy has connected with other Southeast Asian economies and the country improved its external commercial connections. In addition, in 2001, China became one of the members of the WTO, paving the way for further integration into the world economy.

These developments, including the removal of trade barriers, have positively affected China's economy, especially in terms of foreign direct investment (FDI) and exports. China has become an important source of FDI with its improved infrastructure and cheap workforce. With a huge increase in FDI and export of Chinese products, China has thus managed to report double-digit economic growth and become the "world's factory" as the second largest economy of the world. To maintain this economic rise, China has approached the Southeast Asian nations to improve its economic ties.

However, China's economic rise has challenged developing ASEAN countries, as they consider China as a threat to economic development. However, the 1997 Asian financial crisis had a strong effect on Southeast Asian countries' approaches to China in a positive way, as the country behaved as a responsible power and began taking an active role in the regional and global economy. With several Free Trade Agreements, China and ASEAN countries have strengthened their economic relations. China and ASEAN countries have become indispensable trade partners. The economic ties developed under ASEAN's umbrella have paved the way for increased dependence of Southeast Asian countries on China's economy.

The second section of the second chapter specifically addresses the economic relations between China-the Philippines and Vietnam between 2000-2017 to understand the degree of their economic interdependence by measuring them with particular indicators. These indicators include trade, foreign direct investment and financial cooperation, which have also been used by scholars such as Kenneth Waltz and Hirschman. In order to measure the parties' economic interdependence in terms of trade, export and import figures and their shares in the GDP of each country are analyzed.

The Philippines have regarded China as a potential partner for the realization of its economic goals. By 2000 the country decided to deepen its economic relations with China, which has become an important trade partner with a huge share in

country's imports and exports. For China, the Philippines also became an important raw material and fuel supplier. Similar to the Philippines, China has also become Vietnam's number one trading partner, while Vietnam became the second trading partner of China among ASEAN countries.<sup>19</sup>

As their trade relations deepened, China-the Philippines and China-Vietnam FDI relations also were connected. China began to invest in its resource-rich neighbors. Chinese investments were welcomed by both the Philippines and Vietnam due to the remarkable contribution of these developing economies in terms of capital accumulation and technological advancement. Measuring final last indicator, financial cooperation starting from the 1997 Asian financial crisis, each parties' financial connectedness will be covered.

The main aim of the final chapter is to determine the impacts of economic relations between China and aforesaid Southeast Asian countries in terms of security relations by taking the South China Sea dispute as a case study. China's activities in the South China Sea are not acceptable for the Philippines and Vietnam, as they consider these activities to be a threat to their national sovereignty. Therefore, there has been ongoing conflict since the 1990s. Recently, with Scarborough Shoal standoff in 2012, the Philippines' security concerns reached the top.<sup>20</sup> Similarly, after a small-scale skirmish with Chinese vessels in the disputed area in 2011, Vietnam's concerns also increased.<sup>21</sup> As a response to the Chinese threat, both countries have followed similar defense policies as they strengthen their military alliances with the US for external balancing purposes.<sup>22</sup> Also, they increased military spending to modernize and upgrade their military capabilities. Therefore, the chapter concentrates on the reasons of aggression and policy responses of the Philippines and Vietnam against China aggression. While analyzing the case and behavior of parties, this section will use various interpretations of Realist theory.

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<sup>19</sup> Ngoc, p. 201.

<sup>20</sup> Marc Lanteigne, "The South China Sea in China's Developing Maritime Strategy", **Power Politics in Asia's Contested Waters**, (Ed. Enrico Fels and Truong-Minh Vu), Springer, Switzerland, 2016, p.108.

<sup>21</sup> Tung Nguyen Vu, "Vietnam's Security Challenges: Hanoi's New Approach to National Security and Implications to Defense and Foreign Policies", **Security Outlook of the Asia Pacific Countries and Its Implications for the Defense Sector**, NIDS Joint Research Series No. 7, Japan, 2012, p.116.

<sup>22</sup> Denny Roy, "Southeast Asia and China: Balancing or Bandwagoning?", **Contemporary Southeast Asia**, Vol. 27, No. 2, 2005, pp. 310-312.

This study reviews the impact of economic interdependence on security relations of China-the Philippines and Vietnam, arguing that despite improved relations and interconnected economic relations between China-the Philippines and China-Vietnam, conflict is inevitable due to their overlapping claims and sovereignty concerns. According to Neoliberal argument, advanced economic relations help prevent conflicts between states. However, the aforementioned countries' security policies and foreign policy behaviors toward China in the South China Sea dispute make Neoliberal assumptions obsolete. The study asserted that unlike Neoliberal belief, when it comes to security and survival of the states, they are less tolerant and remain ready to risk the gains of their economic relations.





## CHAPTER I

### THEORETICAL FRAMEWORK AND LITERATURE REVIEW

There are various IR theories which purport to explain the behaviors of China and the Southeast Asian states such as political economy, hegemony, constructivism. However, this study focuses only on the debate between liberals and realists. This debate has been in great demand in the history of IR, yet it still cannot be said that it has been shelved by the academicians/researchers who are working on this region, such as Barry Buzan, Gerald Segal, David Shambaugh, and Krishner.

#### 1.1.Literature Review on Economic Interdependence and Security

Over the past decades, many International Relations scholars have attempted to explain the link between the economic interdependence and security from various perspectives. On the one hand, liberals support the idea that there is a positive correlation between these two concepts and that economic interdependence can reduce likelihood of conflict among states and expedite solving security problems. On the other hand, realists refuse these arguments and state that economic interdependence does not prevent uneven distribution of power. Therefore, conflict among states is unlikely to disappear despite having advanced economic relations.<sup>23</sup> Considering the theoretical and empirical work on economic interdependence theory since the Second World War, there is ongoing debate, as no party is able to answer certain vital questions about to what extent and how interdependence affects security relations.<sup>24</sup> Regarding the relation between interdependence and conflict, there are many different propositions in the literature.

Liberal optimism on economic interdependence and peaceful relations dates back centuries. They supported the idea that increase in economic interactions among states decreases the interstate hostilities. Barry Buzan points out that “a liberal economic order makes a substantial and positive contribution to the

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<sup>23</sup> Scott Burchill and others, **Theories of International Relations**, Palgrave Macmillan, New York, 2001, p. 66.

<sup>24</sup> James R. Masterson, “Analyzing China’s Economic Interdependence and Political Relations with its Neighbors”, **China Information**, Vol.26, No.1, 2012, p.5.

maintenance of international security”.<sup>25</sup> Classical liberals unconditionally state that the more states become interdependent, the less likely they are to choose conflict.<sup>26</sup>

Economic liberalism takes this a step further and claim that when states become economically linked with each other, they are less likely to solve interstate problems through use of force. Scholars who are supporters of this idea explain this argument with the opportunity cost consideration. According to Smith, trade policies of states are motivated by their self-interest which brings peaceful relations as the cost of conflict increases, meaning that interdependent states are less likely to use force due to the cost of a loss comes with a disruption in economic relations. A disruption specifically in trade and generally in economic relations can lead to a reduction in the state’s welfare.<sup>27</sup> Meanwhile, Neoliberal scholars like Keohane and Nye believe that complex interdependence brings broaden channels of contacts between states and using military force to solve issues becomes not an option for them.<sup>28</sup> Moreover, Rosecrance states that when interdependence grows states gain from economic interactions increases and they choose to trade rather than war.<sup>29</sup>

Liberal ideas are criticized by realist theories which emphasize that interdependence does not lead to the results that liberals claim. Waltz believes that distribution of gains coming from trade relations can affect interstate relations.<sup>30</sup> Relative gain consideration might alter the balance of power among states in the international system. A shift in power relations can also be a source of military conflict. Kenneth Waltz claims that one state’s dependence on another state can indicate more than the dependence of the latter to the former.<sup>31</sup> This condition may increase the hostility of the less dependent state toward the more dependent. Therefore, realists in general support the idea that interdependence brings conflict.<sup>32</sup> Moreover, for states, maintenance of security and survival is the top priority in an

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<sup>25</sup> Edward D. Mansfield and Brian M. Pollins, **Economic Interdependence and Conflict**, The University of Michigan Press, the United States of America, 2003, p.4.

<sup>26</sup> Paul R. Viotti and Mark V. Kauppi, **International Relations Theory**, Longman, New York, 2010, pp.118-120.

<sup>27</sup> Scott Burchill, p. 64.

<sup>28</sup> Robert O. Keohane and Joseph S. Nye, p. 7.

<sup>29</sup> Richard Rosecrance and Arthur Stein, "Interdependence: Myth or Reality?", **World Politics**, Vol.26, p. 12.

<sup>30</sup> Albert O. Hirschman, **National Power and the Structure of Foreign Trade**, University of California Press, Berkeley, 1969, pp. 7-10.

<sup>31</sup> Kenneth Waltz, **Theory of International Politics**, p.105.

<sup>32</sup> Kenneth Waltz, **Theory of International Politics**, p.105.

anarchic world. Therefore, against any sort of external threats to their security, they are always ready to take the necessary actions.

### **1.2.A Review of Leading Theories on Economic Interdependence and Security**

This section discusses leading theories in IR on economic interdependence and security. There are many different perspectives of IR theories on this topic. Considering the various approaches of main stream theories for the effect of the former on the latter, the main explanation will be made in terms of the framework of realist theory, liberal theory and their variants. Liberals describe the motivation of states in seeking to improve economic relations in an explanatory and persuasive way. Nevertheless, their arguments are lacking in predicting the effects of developed economic relations on states behaviors towards each other, especially when there is a security issue. Realist assumptions may better explain state responses to security threats despite complex economic relations by emphasizing underlying mechanisms and factors such as the desire for power and international anarchy. This may help establish which factors may mitigate or aggravate a security problem such as shifts in balance of power. Despite this, realists' arguments on security problem have been challenged by many different approaches to international relations, including democratic peace theory, economic liberalism, and social constructivism. The main arguments of this study will be shaped in the framework of realist assumptions due to aforementioned reasons.

#### **1.2.1. Realism**

Realism is widely regarded as the leading theory of international relations since the Second World War. Realists consider security as the chief topic of IR and security has been linked to realist thought since its inception.<sup>33</sup> International politics are considered a form of power politics; thus, their arguments are mostly shaped around increasing, protecting or using power. Among the problems states are facing, realists assume that there is a hierarchy and national or international security stands

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<sup>33</sup> Scott Burchill, p. 32.

at the top of it. From the realists' point of view, security issues can also be defined as "high politics", while economic and social issues are viewed as "low politics".

Realists place the "state" at the center of their theory, representing the key unit of analysis.<sup>34</sup> They consider states as the most important actors in the international relations regardless of their type such as ancient Greek city-states or modern nation-states.<sup>35</sup> Realists acknowledge the state as an integrated and unitary actor which speaks one voice and follows one policy at a particular time on a specific issue. Realists also make further assumptions on the basis of the idea that state is fundamentally a rational actor despite human bias and misperceptions. Accordingly, the state always considers all possible alternatives to maximize the benefits in the decision-making process.

Realist theory defines the international system of states as anarchic one. It regards anarchy as the chief determinant of state behavior in IR. According to realists, anarchy is defined as the absence of a higher authority above states; it allows power politics to continue and makes all states vulnerable especially in the presence of revisionist powers.<sup>36</sup> One of the most important consequence of anarchy is the security dilemma, defined by realists as a situation in which an increase in one state's power decreases power of another state, as a result making all states become insecure.

According to scholars like Robert Jervis and John Herz, the security dilemma is able to explain the most significant questions of international relations and security policy.<sup>37</sup> It is a powerful theory for describing general reasons leading to the outbreak of war and perpetuation of peace. The theory has made a huge contribution in explaining major events in international relations, such as the First World War, reasons and end of Cold War or prevention of a possible conflict between China and the USA.<sup>38</sup>

Similar to neorealists, their ideas to be discussed later, Jervis and Herz agree on the idea that the main source of security dilemma is the anarchic structure of

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<sup>34</sup> Scott Burchill, p. 31.

<sup>35</sup> Paul R. Viotti and Mark V. Kauppi, p. 42.

<sup>36</sup> Paul R. Viotti and Mark V. Kauppi, p. 42.

<sup>37</sup> Shiping Tang, p.590.

<sup>38</sup> Shiping Tang, p.588.

international politics.<sup>39</sup> According to Herz, absence of a higher unity increases the concerns about being attacked, dominated and subjected by other groups. Therefore, each group is driven to gain more and more power in order to prevent the impact of the power of others. Accordingly, Herz states that “no state can ever feel entirely secure in such a world of competing units, power competition ensues, and the vicious circle of security and power accumulation is on”.<sup>40</sup> Jervis puts his ideas on security dilemma as follows: “an increase in one state's security can make others less secure, not because of misperceptions or imaged hostility, but because of the anarchic context of international relations”.<sup>41</sup>

Classical realists, such as E. H. Carr, Hans J. Morgenthau and Thucydides, believe that states inner drive is power and domination which comes from selfish human nature.<sup>42</sup> Morgenthau termed it *animus dominandi* (desire to dominate) and in his book “Politics Among Nations” states that “human nature, in which the laws of politics have their roots, has not changed since the classical philosophies of China, India, and Greece endeavored to discover these laws” and he also states “the drives to live, to propagate, and to dominate are common to all men”.<sup>43</sup> Thus, the desire of all states coming from the selfish human nature generates conflicts among them.

The main focus of realists is the conflictual aspects of state relations that the causes of war.<sup>44</sup> Therefore, they rely on deterrence and balancing power of other states in the system.<sup>45</sup> According to realists, states focus on maintaining balance of power among each other that brings peace and help them to guarantee their survival.<sup>46</sup> Thucydides explains the primacy of power politics in his book “The History of the Peloponnesian Wars”, stating that the Peloponnesian war between Spartans and Athenian was related with changing balance of power.<sup>47</sup> Sparta improved its military strength to maintain its unrivaled position and Athens responded to Sparta’s actions accordingly. The war basically occurred due to

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<sup>39</sup> Shiping Tang, p.591.

<sup>40</sup> Shiping Tang, p.591.

<sup>41</sup> Shiping Tang, p.592.

<sup>42</sup> Scott Burchill, p. 32.

<sup>43</sup> Hans J. Morgenthau, **Politics Among Nations: The Struggle for Power and Peace**, McGraw Hill, Seventh Edition, the USA, 1993, p.4.

<sup>44</sup> Scott Burchill, p. 32.

<sup>45</sup> Paul R. Viotti and Mark V. Kauppi, pp. 42-44.

<sup>46</sup> Hans J. Morgenthau, **Politics Among Nations: The Struggle for Power and Peace**, McGraw Hill, Seventh Edition, the USA, 1993, pp. 3-6.

<sup>47</sup> Paul R. Viotti and Mark V. Kauppi, p. 46.

increased power of Athens relative to Sparta's. According to this realist statement, the anarchic system highlights the immanent vulnerability of sovereign states in shifting power balances.<sup>48</sup>

Neorealist scholars agree on most of classical realist ideas mentioned above. For instance, they share the same ideas concerning anarchical structure of the international system, states' motivation for power and the importance of survival. Nevertheless, realists are divided into camps due to differences in their approaches to certain aspects of international relations. One of the core differences originates from their approaches to the reasons of power desire of states.<sup>49</sup>

#### 1.2.1.1. Neorealism

Neorealism is one of the variants of realism, a significant contemporary approach to the international relations. Also known as structural realism, it was introduced by Kenneth Waltz in his book "Theory of International Politics" in 1979.<sup>50</sup> Waltz with his theory contributed to the reformulation of the arguments of classical realists. Neorealist have different argument which differentiate them from the classical realists. They claim that the reasons of states seeking for power has less to do with human nature.<sup>51</sup> The main that of states pursue power is the anarchic nature of international system itself. In anarchy, states main aim is to maintain its survival.<sup>52</sup>

Neorealists explains the reasons of states desire to maximize their power with five assumptions. The first assumption is that states are the main actor of the international system, which operates in anarchy. Waltz sees anarchy as an ordering principle with the absence of a central authority stands above states.<sup>53</sup> The second assumption is that all states have their own military capabilities, which enable them to harm each other. Their military capabilities can change in time.<sup>54</sup> The third

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<sup>48</sup> Paul R. Viotti and Mark V. Kauppi, p. 46.

<sup>49</sup> Tim Dunne and others, **International Relations Theories, Discipline and Diversity**, Oxford University Press, United Kingdom, 2013, p.78.

<sup>50</sup> Paul R. Viotti and Mark V. Kauppi, p. 134.

<sup>51</sup> Kenneth Waltz, **Theory of International Politics**, p. 99.

<sup>52</sup> Kenneth Waltz, "Realist Thought and Neorealist Theory", **Journal of International Affairs**, Vol. 44, No. 1, p. 29.

<sup>53</sup> Kenneth Waltz, **Theory of International Politics**, p.102.

<sup>54</sup> Kenneth Waltz, **Theory of International Politics**, pp.102-104.

assumption is that states cannot be sure about the intentions of other states.<sup>55</sup> They want to know if the other state will use force to change the existing balance of power or it has no interest to change it. In this point, it is not possible to predict their future intentions and the purposes for which they will use their military power. The forth assumption is that the ultimate goal of states is survival.<sup>56</sup> The most significant aim of the states is to keep their territorial integrity and maintain its autonomy.<sup>57</sup> The last assumption is that despite their mistakes, states are rational actors.<sup>58</sup>

The combination of the assumptions mentioned above draws the picture of the concept of the security dilemma in this anarchic system. The concept defines the situation that increase in one state's power are equal to decrease in power of another state. In other words, it is not possible for one state to improve its potential to survive without threatening the survival of other states. Therefore, threatened states take the necessary steps to guarantee their survival and this concerns shape their behaviors. According to Kenneth Waltz, despite functioning similar, states have different capabilities and there is an unequal distribution of power among states.<sup>59</sup> Therefore, the potential of each state to pursue their interest is depended on their relative power.<sup>60</sup>

Structural realists differ in terms of states' motivation for seeking more power. Waltz argues that states should always gain more power because under anarchy there is no guarantee that one state will be attacked by another.<sup>61</sup> In order to feel more secure, they try to be more powerful and their final goal should be to ensure hegemony. States are never sure about the intentions of other states due to uncertainty. This lack of information might result in a competition among them as none of them can tell whether the others are revisionist or not. Also, it is difficult for them to understand if a certain state will take advantage of its military forces.

Similar to Waltz, Mearsheimer claims that "power is a means to an end and the ultimate end is survival".<sup>62</sup> Each player in the game, as every actor in the system,

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<sup>55</sup> Kenneth Waltz, **Theory of International Politics**, p.111-113.

<sup>56</sup> Kenneth Waltz, **Theory of International Politics**, p. 102

<sup>57</sup> Kenneth Waltz, **Theory of International Politics**, pp. 104-111.

<sup>58</sup> Kenneth Waltz, **Theory of International Politics**, pp. 104-111.

<sup>59</sup> Kenneth Waltz, **Theory of International Politics**, p. 82.

<sup>60</sup> Kenneth Waltz, **Theory of International Politics**, p. 82.

<sup>61</sup> Kenneth Waltz, **Theory of International Politics**, p. 102.

<sup>62</sup> Kenneth Waltz, **Theory of International Politics**, p. 70.

both regional and international, aims to survive. States are forced to make alliances and seek power to protect themselves. Therefore, the rising power of a certain state in the international system is considered as a threat to others. However, different than offensive realists, defensive realists think opposite because they point out that if any state become too powerful this will result in balancing. The other states also build up their military powers to balance against the too-powerful state. As a result, powerful state will feel insecure and this situation will destroy balancing. Therefore, defensive realists argue that these simple facts should be also clear for all states in the system and they should limit themselves not to gain more power. Otherwise, by being more powerful, they are just threatening their own survival. However, offensive realists have a different approach, positing that threatened states usually balance against the dangerous states.

The neorealist approach to explain the link between interdependence and security also has shaped their core concepts including security dilemma, power politics and survival. Converse to popular belief, neorealists do not deny the possibility of cooperation among states, arguing that each state sees another's loss as its own gain, making international politics a zero-sum game.<sup>63</sup> They find game theory to be highly relevant to understand the international relations in general owing to anarchy and distribution of power among states.

Due to anarchy, realists are convinced that cooperation is difficult to achieve and maintain. Waltz claims that economic interdependence increases the possibility of conflict among states.<sup>64</sup> He explains the main reason of this idea with "relative gains" that when states make deals, they always consider the relativity of the other side's gains. He also argues that states "are compelled to ask not 'will both of us gain?' but 'who will gain more?'"<sup>65</sup> In the case that one side will gain more than the other, the balance of power shift in favor of the former. Similarly, according to Mearsheimer, relative gains become a problem when there is obvious asymmetry between states because states which have equal powers are not concerned much about relative gains.<sup>66</sup>

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<sup>63</sup> Kenneth Waltz, **Theory of International Politics**, p. 104-111.

<sup>64</sup> Kenneth Waltz, **Theory of International Politics**, p. 107

<sup>65</sup> Kenneth Waltz, **Theory of International Politics**, p. 105.

<sup>66</sup> John J. Mearsheimer, "The False Promise of International Institutions", **International Security**, Vol. 19, No. 3, 1995, p. 12.



Neorealists also argue that states cannot solve security issues although their developed economic relations when the issue is about their survival. There is a high possibility that states have common interests, but the uncertainty makes it hard for them to cooperate. They are worried about the relative gains made by other states, as well as the possibility of dependence on other states. Therefore, when security interests have greater importance, states are willing to tolerate losses from a possible economic disruption. Waltz and Mearsheimer support a different idea with an example from the 19th century. They state that in the 19th century western trading system was in a high level of interdependence; however, this did not prevent World War I. Evidently, when states feel threatened, they may take any kind of military actions and do not consider the cost of breaking economic relations for their national security.<sup>67</sup>

### **1.2.2. Liberalism**

Classical liberalism, which is another mainstream theory of International Relations, has a different approach to the relation between interdependence and security. Prior to explaining liberals' assumptions on the topic in detail, it is worth describing the four basic assumptions of liberal theory in general. First, for liberals, states and non-state actors are both important in world politics. According to them, non-state actors are as influential as state itself. Second, unlike classical realists, the state is not depicted as a unitary actor with the cooperation of institutions and states anarchy can be eliminated. Third, liberals believe that anarchy does not determine the behavior of states on its own. Economic interconnection among states and non-state actors can also have an effect on state behaviors. Fourth, liberals reject the idea that international politics are only about power and security issues. For them, economic and social issues also matter; thus, they are not in favor of making a distinction on the topic as high and low politics.

Unlike realists, liberals believe that state preferences cannot be reduced only seeking for security or wealth as it is something more complex than this reduction. Liberals state that modern states are not Spartan to compromise on sovereignty to achieve other state goals, or that they do not seek only for power in the sense of

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<sup>67</sup> Paul R. Viotti and Mark V. Kauppi, p. 134.

domination.<sup>68</sup> Instead of considering state preferences as fixed, unlike realists, liberals try to explain variations in states' preferences and their importance for world politics. Liberals, including Neoliberal institutionalists, agree on the rational-actor model, but think that states choices are affected by calculations of "transaction costs" and complex interactions.<sup>69</sup> Therefore, Neoliberal claim that states' goals are influenced by many factors, which also shape the states behavior.<sup>70</sup>

Liberals agree with realists on anarchic side of the international system and war was a defining characteristic of international politics. However, different than realists they believe in the possibility of harmony in states interests which make them collaborate and can be a factor to prevent conflict and war.<sup>71</sup> According to liberal assumptions, collaboration is possible when there is a convergence in actors' interests in some certain areas even in anarchic international system. Unlike realist, they focus on absolute gains rather than relative gains. They have a positive-sum perspective and claim that it is possible to increase the size of the pie and anyway, that all can win.<sup>72</sup>

Unlike realists, liberals think that war and commerce is incompatible. According to liberals, free trade is a peaceful means to achieving national wealth. Trade can help to mitigate or break down any kind of divisions between states, expand the level of understandings between nations and broaden the range of contacts. Thus, trade eliminates the risk of international tension. According to Kant, commerce between people unite them in a common, peaceful enterprise.<sup>73</sup> Similar to Kant, Ricardo also claimed that free trade "binds together, by one common tie of interest and intercourse, the universal society of nations throughout the civilized world".<sup>74</sup> With the same approach, John Stuart Mill stated that trade prevents war: 'it is commerce which is rapidly rendering war obsolete, by strengthening and multiplying the personal interests which act in natural opposition to it'.<sup>75</sup> In general,

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<sup>68</sup> Andrew Moravcsik, "Taking Preferences Seriously: A Liberal Theory of International Politics", **International Organization**, Vol.51, No.4, 1997, p.520.

<sup>69</sup> Moravcsik, p.516

<sup>70</sup> Paul R. Viotti and Mark V. Kauppi, p. 119.

<sup>71</sup> Paul R. Viotti and Mark V. Kauppi, p. 122.

<sup>72</sup> Scott Burchillp. 63.

<sup>73</sup> Scott Burchill, p. 63.

<sup>74</sup> Scott Burchill p. 63.

<sup>75</sup> Scott Burchillp. 63.

liberals support the claim that trade creates mutual dependence and reduces conflict, because the economic interests of each state become an obstacle for war.

#### 1.2.2.1. Neoliberalism

On top of sharing the same ideas with classical liberals, in the late 1970, scholars from different schools began to criticize realist approaches. Robert O Keohane and Joseph S. Nye approached the fundamental assumptions of classical and structural realism differently with their “the theory of complex interdependence”. Their theory brought a different point of view to realist efforts to explain state behavior with military and economic capabilities. Interdependence has also become a significant part of the Neoliberal theory, helping to explain why states have a tendency to cooperate and reduce the risks of conflict in an anarchical system.<sup>76</sup>

In general, the term interdependence is used for defining the situation in the world politics where all states are dependent on each other. When international relations scholars use dependence and interdependence, they usually refer to self-sufficiency and the vulnerability of a state in changing its relationship with another state, especially trade relations.<sup>77</sup> Keohane and Nye, define this by putting mutual benefits to the center and according to them economic interdependence refers to an economic relationship that is costly to break.<sup>78</sup>

Prior to putting Neoliberal ideas forth on the relation between economic interdependence and conflict, it is worth covering the details of Keohane and Nye’s theory of complex interdependence. Complex interdependence has three essential characteristics: multiple channels, absence of hierarchy among issue, minor role of military force.<sup>79</sup> To start with the first one, Keohane and Nye developed a different approach to the unitary state assumption of realism. They claim that there are many channels connecting states including informal ties and transnational organizations such as banks and corporations. This interconnectedness makes states policies more sensitive in the sense that states can be affected by each other easily.<sup>80</sup>

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<sup>76</sup> David Harvey, **A Brief History of Neoliberalism**, Oxford University Press, New York, 2005, p. 2.

<sup>77</sup> David A. Baldwin, p.485.

<sup>78</sup> Robert O. Keohane and Joseph S. Nye, p.8.

<sup>79</sup> Robert O. Keohane and Joseph S. Nye, p.17.

<sup>80</sup> Robert O. Keohane and Joseph S. Nye, p.26.

Second, they also state that there is no hierarchy among the issues in international relations.<sup>81</sup> In comparison to other issues, security is not dominate in their agenda, as realists claim that in complex interdependence, any issue can be the top topic. Keohane and Nye believe that in this interdependent system states tend to cooperate because it is the common interest of all and this situation brings stability in the international system.<sup>82</sup> They also claim that states' main motivation is not seeking for power, as realists hold. Unlike realists, Neoliberal point out that there cannot be simple division in international politics as "high" and "low".<sup>83</sup> According to their point of view, high politics issues including national security and military power are still important however, low political issues including economic and social issues are as significant as the former.<sup>84</sup>

Third, they also emphasize the minor role of using military force in solving problems among states. Unlike realist view which gives importance to force and survival, complex interdependence claim that force has less primacy. The theory states that using force to achieve a goal is both costly and uncertain. They believe that when there is interdependence, using military force in solving issues is irrelevant even for survival.<sup>85</sup>

Keohane and Nye put commerce and free trade at the center of the modern interdependence theory and claim interdependence refers not only to defining the situation of equally balanced mutual dependence. In this point, they emphasize asymmetries among states. They define asymmetry as a link between interdependence and power meaning that less dependent state has a leverage on more dependent state. Thus, interdependence creates vulnerability and power. Asymmetric interdependence occurs when the losses of more dependent state is greater than the less dependent one. To explain the effect of power on interdependence and how it alters the behaviors of states more concrete, they use vulnerability and sensitivity.

They use the term sensitivity to express the degree of a state being sensitive to changes in a certain area. According to them vulnerability means the extent of

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<sup>81</sup> Robert O. Keohane and Joseph S. Nye, p.25.

<sup>82</sup> Robert O. Keohane and Joseph S. Nye, p.25.

<sup>83</sup> Robert O. Keohane and Joseph S. Nye, p.25.

<sup>84</sup> Robert O. Keohane and Joseph S. Nye, p.25.

<sup>85</sup> Robert O. Keohane and Joseph S. Nye, p.28.

states ability to control their responses to sensitivity.<sup>86</sup> It can be also be described as the cost of avoiding from changing the existing rules of the game. When there is asymmetrical interdependence among parties, a weaker state is more vulnerable to the external changes because their cost is high.<sup>87</sup> Thus, vulnerability has the potential to create a coercive threat or action by the less dependent state.<sup>88</sup>

Putting this argument forward, liberals and especially commercial liberals came to the conclusion that economic interdependence encourages states not to act aggressively.<sup>89</sup> The dependence of one country to the other also brings the dependence of latter to the former and it creates basis for them to have common interests opposed to war. Similarly, John Stuart Mill followed the idea that commerce causes mutual dependence and it brings peace. In addition, Hirschman states that increasing level of economic relations create positive interactions between states and they serve as deterrent to future conflicts.<sup>90</sup> They think from the opportunity cost perspective and as trade brings economic benefits for both parties, war would disrupt trade and cause the loss of the benefits of trade. This kind of considerations deter states to conflict with their trading partners. For instance, an increase in regional economic integration in Europe parallels the idea that conflict between states would be reduced by economic collaboration. Thus, states such as Germany and France would be able to cooperate.

To the liberal assumption that economic interdependence prevent conflict, neorealists have a few counterarguments. First, they argue that anarchy and its consequence, survival concerns, will always be priority of states over the willingness of having economic prosperity. In other words, economic interdependence will never take superiority over security, as states are primarily concerned with their survival. They again emphasize the importance of relativity of power. As Waltz states “the relativity of power requires states to be more concerned with the relative strength than absolute advantage”.<sup>91</sup> Second, interdependence does not eliminate hegemony

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<sup>86</sup> Jean-Marc F. Blanchard and Norrin M. Ripsman, “Rethinking Sensitivity Interdependence: Assessing The Trade, Financial, And Monetary Links Between States”, **International Interactions**, Vol.27, No.2, 2001, p. 98.

<sup>87</sup> Jean-Marc F. Blanchard and Norrin M. Ripsman, p.99.

<sup>88</sup> Jean-Marc F. Blanchard and Norrin M. Ripsman, p.99.

<sup>89</sup> Scott Burchill, p. 66.

<sup>90</sup> Hirschman, p. 5.

<sup>91</sup> Kenneth Waltz, **Theory of International Politics**, p. 105.

and the situation in which the power is distributed unevenly. Therefore, conflict among states is unlikely to disappear despite having advanced economic relations.<sup>92</sup>

In the economic relationships of smaller economies which are also more dependent with less dependent economic powers, smaller states would pay high costs in a disruption. In this framework, more dependent states cannot take risk of endangering its economic relations. Therefore, from liberal point of view, small states should bandwagon rising powers with absolute gain consideration. According to Waltz, a state which wants to have a share from a success of a rising power might choose bandwagoning. However, considering states as rational actors, they might focus on relative gains and choose balancing behavior states do not want to be vulnerable to a powerful partner.<sup>93</sup> In addition, states use both internal and external balancing to deter and defeat the aggressor state. Internal balancing take place when a state starts increasing its own capabilities by increasing its military spending. External balancing occurs when a state makes alliances with stronger states to control the power of the aggressor state.

This chapter has covered different theoretical approaches to economic interdependence and security in international relations. As it was discussed, Neoliberal argue that economic interdependence can reduce likelihood of conflict among states and expedite solving security problems. Unlike Neoliberals, neorealists state that economic interdependence does not prevent undistribution of power. Therefore, conflict among states is unlikely to disappear despite having advanced economic relations.<sup>94</sup> It has already been experienced that liberal theory has failed to explain cases such as the reasons behind the First World War and the end of the Cold War. Similarly, this study will demonstrate that Neoliberal theory has failed in explaining the effect of economic interdependence on security relations of China and its Southeast Asian neighbors in the South China Sea.

The next chapter will focus on economic relations of China-Philippines and China-Vietnam in detail in order to illustrate their economic interdependence. It aims to put forth the extent of economic interdependence between parties by using certain indicators. It highlights China's economic rise and its historical background, starting

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<sup>92</sup> Scott Burchill, p. 66.

<sup>93</sup> Scott Burchill, p. 38.

<sup>94</sup> Kenneth Waltz, **Theory of International Politics**, p. 106.

from China's efforts to liberalize its economy in the 1980s. Then, it explains the parties' economic relations between 2000-2017 using the indicators of trade, foreign direct investment and financial cooperation.



## **CHAPTER II**

### **ECONOMIC RELATIONS OF CHINA AND SOUTHEAST ASIAN COUNTRIES**

The main aim of this chapter is to determine the extent of relevant the parties' interdependence and examine their economic relations with China. Keohane and Nye's concept of economic interdependence is adopted to explain current economic relations between China and its southeastern partners. The chapter examines this interdependence specifically in the context of China-Vietnam and China- Philippines in a more concrete framework.

Liberals generally hold that China's economic development will have a positive effect in the region in terms of economy advancement and peace. China become integrated into the international economy after implementing liberal economic reforms. As a result, the country has made huge strides in economic development and emerged as the second largest economy in the world. However, for the continuation of its economic development and growth, China must eliminate numerous external obstacles. At this point, relations with the the Southeast Asian countries have become essential for China. Therefore, China has followed a trade-based peaceful path towards decent relations with its southeastern neighbors. ForSoutheast Asian countries, it is also important to maintain close relations with China.

China has signaled to ASEAN countries that the nature of their collaboration is win-win in order to reassure them that their economic relation is based on mutual benefits. According to liberal scholars, such as Keohane, the theory of cooperation requires that the countries with common interests can develop mutually advantageous relations. China has promoted the traditional international relations



concept of “win-win cooperation” as the foundation of its proactive commercial strategies.

On the one hand, those countries benefit from the opportunities provided by China in the maintenance of their economic growth. While they provide broadened market access, raw materials, energy resources and intermediate products to China, they receive financial support and privileges with low tariff in trade in return. Therefore, they have developed their economic relations with China and enjoyed significantly expanding trade volumes.

On the other hand, liberal often fails to mention that China, as a rising super economic power, poses a challenge to its neighboring countries as well.<sup>95</sup> From a regional perspective, the developing economies of Southeast Asia should consider China as a rival for their export and foreign direct investment. The increasing economic influence of the Chinese economy has increased the fear of developing economies of the region.<sup>96</sup> This may signal their increasing dependence on the Chinese economy.

For further analysis in measuring the degree of dependence of the countries, this chapter uses some specified indicators. These indicators are those used by scholars like Kenneth Waltz and Albert Hirschman.<sup>97</sup> They are also adverted by the Organization for Economic Cooperation and Development (OECD) in a 1983 report.<sup>98</sup> They include trade, foreign direct investment and financial cooperation.

This chapter will examine trade as the first indicator. International trade statistics are used while measuring economic interdependence empirically because if two states trade it means it is beneficial for both sides otherwise interstate trade would not take place. In addition, trade has a larger place in countries' economies and is directly related to their national welfare and their GDP thus they rely on it for their development. Therefore, trade is one of the most important indicators to

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<sup>95</sup> Rosemary Foot, “China’s Policies Toward the Asia-Pacific Region Changing Perceptions of Self and Changing others’ Perceptions of China”, **Rise of China Beijing Strategies and Implications for the Asia-Pacific**, (Ed. Hsin-Huang Michael Hsiao and Cheng-yi Lin), Routledge, London, 2009, p.136.

<sup>96</sup> Choong Yong Ahn and others (Ed.), **East Asian Economic Regionalism, Feasibilities and Challenges**, Springer, The Netherlands, 2005, p.35.

<sup>97</sup> Albert Hirschman's National Power and the Structure of Foreign Trade and in Kenneth Waltz's article on "The Myth of National Interdependence".  
Blanchard, p.99.

<sup>98</sup> Blanchard and Ripsman, p.99.

measure China and Southeast Asian countries' economic relations.<sup>99</sup> While analyzing the trade relations, this chapter will measure it by checking both economy-trade interdependence and partner-trade interdependence. Also, the chapter uses numerical data concerning the export and import rates between China and its Southeast Asian partners between 2000 and 2017 as a main source.

Second indicator is foreign direct investment as it is crucial for economic interdependence. FDI flows has growing impact on states' economies as world FDI has increased 800 % since 1970.<sup>100</sup> FDI also permanent and removing it from the host country is costly. FDIs are directly linked to the economic relations of countries thus their economic interdependence as there is a cost of probably disruption. Third and the last indicator in measuring interdependence is financial cooperation. It includes basically monetary cooperation and banking relations. Increase in financial connected through monetary cooperation, banking, bond markets and swap agreements lead financial sensitivity for the more dependent economies. This sensitivity endangers stable economic growth; thus, the cost of disruption in financial relations increases. In this respect, the existing interstate financial interconnectedness<sup>101</sup> of China-Vietnam and China-the Philippines will be discussed.

Prior to examining these indicators, the next section explores China's economy, which is the driving force of the economic interdependence in the region. Contrary to popular belief, China's path to becoming the world's biggest economic power has not been smooth. In fact, in the 1950s and 1960s, China followed a very different economic development model. Yet, the Chinese miracle that started with liberalization efforts in the 1980s has maintained its constitutive effect on Chinese economic growth.

## **2.1. CHINA AS A RISING ECONOMIC POWER**

### **2.1.1. China's Long Rise to Economic Stardom: A Brief History**

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<sup>99</sup> Blanchard and Ripsman, p.98.

<sup>100</sup> James R. Masterson, "Analysing China's Economic Interdependence and Political Relations with Its Neighbours", *SAGE Journals*, Vol.26, No.1, 2012, pp. 310.

<sup>101</sup> In this study financial interconnectedness refers to the state of countries being financially connected to one another through the financial institutions(banks), bond markets and financial agreements on currency swap.

"Understanding Financial Interconnectedness", International Monetary Fund, <http://www.imf.org/external/np/pp/eng/2010/100410.pdf>, (08.05.2017).

In the 1950s and 1960s, the Chinese economy was organized in a different way that left it isolated and weak. Under the leadership of Mao Zedong, it was a centrally-planned economy, which had similar patterns with the Soviet economic model.<sup>102</sup> All kinds of industrial inflows and outflows were assigned in compliance to a plan prepared by the State Planning Commission. Therefore, the impact of market forces on trade and industry were minimized and foreign trade was limited. There was collectivized agriculture, while prices, wages and interest rates were under state control. Furthermore, more than half of the production, based on planned output targets, was carried out by state-owned enterprises.<sup>103</sup>

During the Mao era, China experienced a serious economic crisis as a result of two specific sociopolitical and economic events. The first was the economic and social campaign of the Chinese Communist Party (CCP) “the Great Leap Forward”, which aimed to make a transition from an agriculture economy to a socialist economy with an industrial society from 1958 to 1960. However, agricultural collectivization and forced labor resulted in the Great Chinese Famine and the deaths of millions of people.

The other event was the Cultural Revolution, which was a social upheaval on a nationwide scale, covering the time period from 1966 to 1976. It deeply influenced the mentality of the Chinese people in a way never seen in Chinese history before.<sup>104</sup> All citizens became involved in political fight and chaos as the revolution provoked political humiliation, torture and murders all over the country.<sup>105</sup> Its outcome was negative, similar to the Great Leap Forward. Due to the political chaos there was a disruption in the economy. China’s living standards decreased to 9.6 % from 20.3 % due to the decline in per capita GDP.<sup>106</sup>

Following the death of Mao in 1979, economic changes and reforms in China began under the leadership of Deng Xiaoping. The reformist leader advocated the

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<sup>102</sup> Wayne M. Morrison, China’s Economic Rise: History, Trends, Challenges, and Implications for the United States, **Congressional Research Service**, 2015, p.2.

<sup>103</sup> Charles Harvie, “Economic Transition: What Can Be Learned from China’s Experience”, **International Journal of Social Economics**, Vol. 26, No. 7, 1999, p.1107.

<sup>104</sup> Wai-Tong Lau, “Songs Tied onto the Chariots: Revolutionary Songs of the Cultural Revolution of China (1966-1976)”, **Journal of Historical Research in Music Education**, Vol. 29, No. 2, 2008, p.98.

<sup>105</sup> Lau, p.99.

<sup>106</sup> Morrison, p.3.

reconstruction of Chinese economy with a utilitarian approach and refused the dominant role of ideology in economic and political developments. His main focus was to achieve economic development; thus, it did not matter to him if an economic policy was considered as “capitalist” or “socialist”.<sup>107</sup> As a result of Deng’s determination, China began opening its economy to the global market and applying liberal economic policies in 1980s.

Deng’s main objectives under the Chinese state capitalism were to construct an integrated modern industrial system, to manage this system with an adequate level of production, and to become integrated into the world economy, then dominated by the United States, Europe and Japan.<sup>108</sup> Therefore, the Chinese government implemented a set of economic reforms to transition itself from the old economic model to the new one. Eschewing a fast pace to ensure political support and economic efficiency, economic reforms were gradually implemented. Experimental free market reforms were carried out within specific time intervals. After testing the applicability and success of these reforms, they were implemented in wider areas.<sup>109</sup>

To be more specific, as the agricultural activities are carried out with central planning, the Chinese government implemented rural and agricultural reforms from 1978 to 1984. Next, industrial sectors became the main focus, and several reforms were conducted from 1984 to 1988. The third reform came through the rectification program during 1988-1991 which aimed at eliminating state price control of a broad range of consumer products, and sought to reduce the pressures and effects of inflation on the economy.<sup>110</sup>

In the process of implementing the reforms mentioned above, there were also external developments that played a significant role in China’s economic rise. The first was China’s replacement of Japan’s economic position. During China’s economic transition, Japan was the most powerful economy of the region. Therefore, the region was under the effect of the Japanese initiatives. One of those initiatives

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<sup>107</sup> Morrison, p.4.

<sup>108</sup> Samir Amin, “China”, *Monthly Review*, Vol.64, No.10, 2013, <https://monthlyreview.org/2013/03/01/china-2013/>, (05.02.2017).

<sup>109</sup> Charles Harvie, “Economic Transition: What Can Be Learned from China’s Experience”, *International Journal of Social Economics*, Vol. 26, No. 7, 1999, p. 1107

<sup>110</sup> Morrison, pp.12-14

was the “Flying Geese” model of manufacturing.<sup>111</sup> After 1980s, Japan implemented this model of manufacturing based on comparative advantage which led the integration of developed economies with less developed ones.<sup>112</sup> However, China has replaced Japan’s economic leadership. In 1990, China’s economic liberalization and a transition to free market allowed Southeast Asian states access to the Chinese market. The establishment of commercial connections with China also led isolated small states such as Vietnam to be integrated to trade links of the region and open up their economies.<sup>113</sup>

The second external development was China’s ascension to the WTO in 2001. China made comprehensive commitments about decreasing its average tariff levels to 10%, eliminating non-tariff barriers and opening service markets to foreign investment. These factors have boosted free trade agreements with other economies. Therefore, China is likely to continue the liberalization process of trade.<sup>114</sup>

These external developments did not prevent the continuation of the ones at home. Later on, China created four special economic zones in the country’s coastal region for free trade to encourage foreign investment. With its “open door policy,” China thus carried out liberalization in trade and removed all barriers to trade, such as providing currency convertibility and reformation of taxes.<sup>115</sup> Therefore, after this transition China’s import and export rates as well as its trade performance has increased. The abolishment of trade barriers has positively affected Chinese economy, especially in terms of FDI and exports.

### **2.1.2. Consequences of Economic Liberalization: “A rapid increase” in FDI and Export**

Most scholars agree that China's economic growth depends on two leading factors: FDI and export. To start with FDI, in recent years, developing countries have

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<sup>111</sup> “The flying factory”, **Economist**, 13.11.2014, <http://www.economist.com/news/special-report/21631799-asia-has-built-web-economic-interdependence-which-china-would-be-ill-advised>, (15.03.2017).

<sup>112</sup> The flying factory.

<sup>113</sup> John Wong and others, “New Dimensions in China-ASEAN Relations”, **China-ASEAN Relations Economic and Legal Dimensions**, (Ed. John Wong, Zou Keyuan and Zeng Huaqun), World Scientific Publishing, Singapore, 2006, p.4.

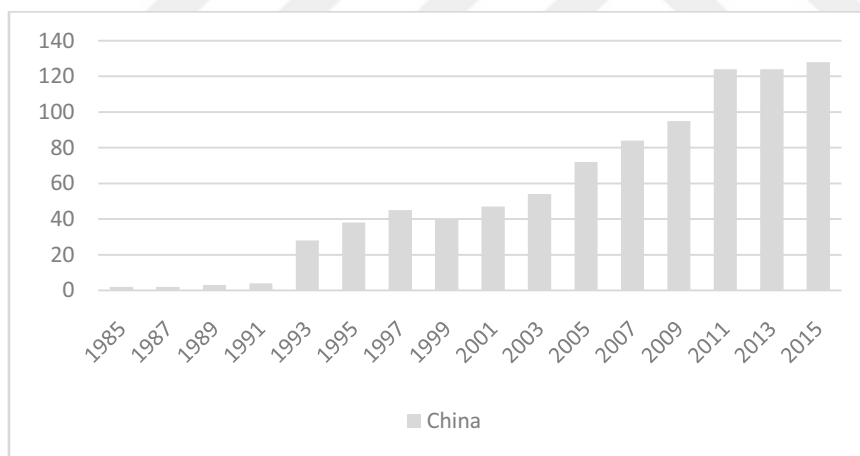
<sup>114</sup> Ahn and others, pp.14-15

<sup>115</sup> Morrison, p.16.

appeared as a source of FDI and prosperous enterprises in international relations. As the world's fastest growing economy, China has been a good example of this trend as well. The country became an attractive location for FDI with its improved infrastructure and cheap workforce source. Then, it has improved its infrastructure with a high inflow of FDI.

From 1985 to 2003, China's FDI flow rose from 2 billion \$ to 41 billion \$, and in 2013 FDI in China was 241 billion \$.<sup>116</sup> In 2005, the accumulated amount of FDI was 60.3 billion \$, it reached to 145.7 billion \$ in 2015.<sup>117</sup> China became the world's most attractive country of FDI. Moreover, according to the UNCTAD Statistics of 2015 China is the largest recipient of FDI in the world. China has achieved successful economic development in many different sectors, ranging from textile to technology. It further enjoys an advantage in global outsourcing of manufacturing.<sup>118</sup>

**Figure 1:** China's GDP per capita (1985-2015)



Source: Trading Economics, <http://www.tradingeconomics.com/china/gdp-per-capita>, (05.04.2017).

The second leading factor is exports. 60% of FDI's are in manufacturing sectors. Export-oriented FDI projects have further accelerated the export of Chinese

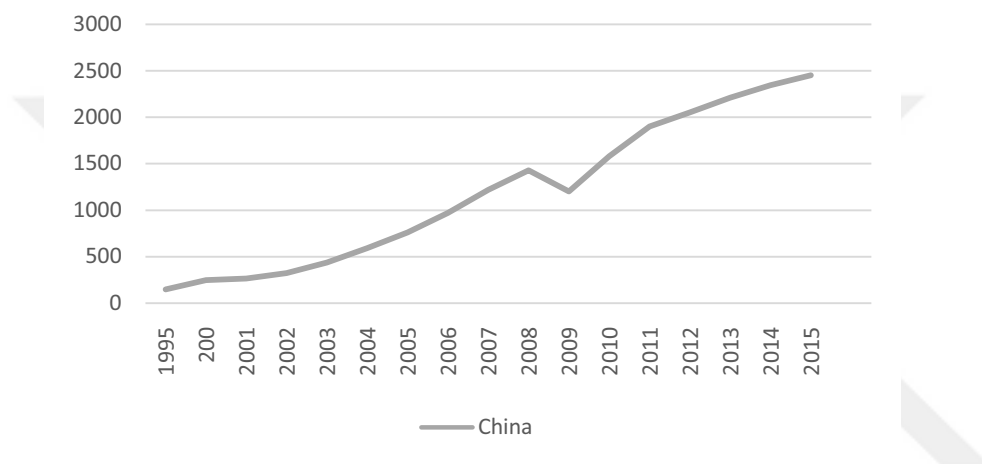
<sup>116</sup> The World Bank, <http://data.worldbank.org/indicator/BX.KLT.DINV.CD.WD?locations=CN>, (16.02.2017).

<sup>117</sup> Trade Economics, <http://www.tradingeconomics.com/china/foreign-direct-investment>, (06.04.2017).

<sup>118</sup> Justin Paul, "The Rise of China: What, When, Where, and Why", **The International Trade Journal**, Vol.30, No.3, 2016, p.207.

manufacture products.<sup>119</sup> Also, China's average economic growth rate was 9.7 in 1990; it kept this rate at 9.76 percent from 1990 until 2016.<sup>120</sup> Therefore, China has become a central place for production, investment, import, and export and thus earning its nickname as "the world's factory".<sup>121</sup> As a result, in addition to having the largest economy in Asia, China has recently emerged as an important international actor due to its fascinating economic growth and high export rates.<sup>122</sup>

**Figure 2:** China's Export between 1985- 2015 (US\$ billion)



Source: Morrison, p.21

In the 21<sup>st</sup> century, China has become the second largest economy in the world.<sup>123</sup> Moreover, China has been the country which most profited from globalization in comparison to other countries. While Korea had 1.1 percent and the US, 1.8 percent, China achieved 4.5 percent of average annual export growth. Additionally, China's annual gross domestic product (GDP) growth reached 7.86 percent, higher than other developing countries and the US.<sup>124</sup>

<sup>119</sup> Ahn, pp.24-26.

<sup>120</sup> Trade Economics, <http://www.tradingeconomics.com/china/gdp-growth-annual>, (06.04.2017).

<sup>121</sup> Paul, p.210.

<sup>122</sup> Phillip C. Saunders, "China's Role in Asia", **International Relations of Asia**, (Ed. David Shambaugh and Michael Yahuda), Rowman and Littlefield Publishers, the United States of America, 2008, pp.127-150.

<sup>123</sup> Alex E. Fernandez and Barbara Hogenboom, "China's Growing Economic and Political Power: Effects on the Global South", **The Asia-Pacific Journal**, Vol.5, No.12, 2007, pp.3-4.

<sup>124</sup> Fernandez and Hogenboom, p.2.

The continuity of China's economic success has become a vital strategic consideration. As regional peace and stability constitutes the basis for these necessary conditions, China has turned its direction to Southeast Asia. China's willingness to maintain its economic development resulted in a deflection in the country's approach toward the Southeast Asia. Compatible to the Neoliberal point of view, China discovered the importance of economic interdependence in the sense that its economy depends on what happened in other economies in Asia. At this point, Chinese leaders considered engagement with regional economies as valuable because it was related to China's economic self-interests.<sup>125</sup> Also, China was participating actively in the regional and global economy.<sup>126</sup>

China's support to ASEAN countries during the 1997 Asian financial crisis is one of these initiatives, as it helped both sides to improve their perceptions to each other. The crisis started as an exchange-rate crisis in Thailand and in a short time spread to the rest of the Southeast Asia. It caused tragic devaluation of local currencies of Southeast Asian nations, inflation, poverty and unemployment.<sup>127</sup> In this point, China provided economic assistance and financial supports to Southeast Asian states suffering from the damage to their economies caused by the crisis.<sup>128</sup>

This steps which China has taken in the financial crisis led to a change in Southeast Asian countries approach to China in a positive way. As a result, China's engagement with ASEAN states has started and China has gained full dialogue partner status. China also has sought to develop bilateral trade in Southeast Asia.<sup>129</sup> With the purpose of developing existing economic relations with Southeast Asian countries, China has initiated some economic arrangements, among these the FTA.<sup>130</sup>

They signed a framework agreement which is the ASEAN-China Comprehensive Economic Cooperation Agreement to establish a free trade area

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<sup>125</sup> Dilip K. Das, "China and the Asian Economies: mutual acceptance, economic interaction and interactive Dynamics", **Journal of Contemporary China**, Vol.22, No.84, 2013, p.1090.

<sup>126</sup> Das, p.1091.

<sup>127</sup> Fenna Egberink and Frans-Paul van der Putten, "ASEAN, China's Rise and Geopolitical Stability in Asia", **Netherlands Institute for International Relations**, No.2, 2011, p.11.

<sup>128</sup> Shekhar, p.257.

<sup>129</sup> Salidjanova and Koch-Weser, p.4.

<sup>130</sup> Ka Zeng, "China's Free Trade Agreement Diplomacy", **The Chinese Journal of International Politics**, Vol.1, No.29, 2016, p.7.



(ACFTA).<sup>131</sup> Under the framework of China's Good Neighbor policy, the establishment of China-ASEAN Free Trade Area (CAFTA)<sup>132</sup> was the most important step in developing trade relations with Southeast Asian countries. They also signed the Trade in Goods of the Framework Agreement on Comprehensive Economic Co-operation in 2004 when they cut the tariffs for more than 7000 products in 2005.<sup>133</sup>

ACFTA can be considered as a milestone in their economic relations. From the ASEAN perspective, it was a first free trade agreement with an external power. Therefore, it reveals that China stands at the center while ASEAN seeking for political and economic opportunities.<sup>134</sup> From Chinese perspective, this FTA is the first one which China concluded with other countries. In addition, ACFTA is one of the largest free trade areas after the European Union (EU) and North American Free Trade Agreement (NAFTA), and has had colossal effect on the parties' economies with its wide extent and opportunities.

China has introduced a key strategic concept which called "Peaceful Rise" in order to undermine the power of the negative approach of its neighbors to China's being an economic power.<sup>135</sup> In practice, this concept incorporates economic diplomacy, multilateralism and good neighborliness. Under economic diplomacy, China has allowed developing economies of the region to benefit from its economic potential for their own developments through regional economic arrangement.<sup>136</sup> Later on, to ease the negative associations of the word "rise", the concept changed

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<sup>131</sup> "Overview of ASEAN-China Dialogue Relations", **Association of Southeast Asian Nations**, [http://asean.org/?static\\_post=overview-asean-china-dialogue-relations](http://asean.org/?static_post=overview-asean-china-dialogue-relations), (20.03.2017).

<sup>132</sup> As a framework for economic cooperation, CAFTA can be divided into three levels: (a) the Product FTA signed in 2005 and completed in several stages; (b) the Service Sector FTA signed and implemented in 2007; and (c) the Investment Agreement signed in Bangkok, Thailand, in 2009. China and six ASEAN countries established a free-trade area that took effect formally in 2010.

Wan-Ping Tai and Jenn-Jaw Soong, "Trade Relations between China and Southeast", **The Chinese Economy**, Vol.47, No.3, p.28.

<sup>133</sup> One of the important points of the ACFTA would be that the most of the products had zero tariffs for the Philippines in 2010 and for Vietnam in 2015.

Das, p.1092.

<sup>134</sup> Etel Solingen, "From 'threat' to 'opportunity'?", **China, the United States, and Southeast Asia: Contending Perspective on Politics, Security, and Economics**, (Ed. Evelyn Goh and Sheldon W. Simon), Routledge, Oxon, 2008, p. 17.

<sup>135</sup> Masako Ikegami, "China's Grand Strategy of Peaceful Rise", **Rise of China Beijing Strategies and Implications for the Asia-Pacific**, Routledge, London, 2009, p.21.

<sup>136</sup> Ahn, p.37

into “peaceful development”.<sup>137</sup> Therefore, China has made progress in gaining trust and confidence of ASEAN countries with expressing its becoming an economic power in a soft way by using “peaceful development” on its official announcements.

Furthermore, China expressed that the period extending to 2020 is a “period of strategic opportunity” for the continuation of its economic development and growth.<sup>138</sup> From the liberal perspective, China’s policy goes beyond statesmanship and politics and seems permanent, as it has lasted for decades. In this regard, the importance of the region increased due to China’s economic initiatives which aimed to have closer economic ties by treating neighbors as friends or partners.<sup>139</sup> One of them was China’s proposal to improve existent ACFTA, as previously mentioned, and the second was the creation of the Maritime Silk Route in twenty-first century under One Road One Belt initiative of China combined with the Asian Investment and Infrastructure Bank (AIIB).<sup>140</sup> In economic terms, these initiatives seek to put China at the center of a quickly deepening regional economic integration process. They also signal China’s plans to foster the economic dependence of Southeast Asian countries on itself, even while they also benefit from its rise.

All those developments between China and ASEAN countries have resulted in that they have become indispensable trade partners for each other. Bilateral trade between China and ASEAN has grown swiftly after 1991 and by 2005 trade volume became 15 times more than it was in 1991. ASEAN export to China also increased over 46 percent by 2005 and became 52.4 billion \$. Between the years 2005-2014, it reached 380 billion \$ which is three times more than it was in 2005. In 2000, ASEAN’s trade with China was 4 percent of its total global trade. Yet, it reached to 10.5 in 2005 and 17.5 percent in 2014. Therefore, in a short period of time China has replaced Japan’s position with its substantial economic ties with ASEAN. China became the third country in the rank of countries which are trading with ASEAN, while ASEAN was China’s fifth. In comparison, while the United States, the existing hegemon, was the fourth largest with 8.2 percent share, China was the largest

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<sup>137</sup> Ikegami, p.22.

<sup>138</sup> Bonnie S. Glaser, “China’s Grand Strategy in Asia”, CSIS, 2014, p.2.

<sup>139</sup> Glaser, pp.4-5.

<sup>140</sup> Nguyen Thi Bich Ngoc, “Vietnam-China Economic Relations and Recommendations for ASEAN-China Cooperation”, **Chinese Global Production Networks in ASEAN**, (Ed. Young-Chan Kim), Springer, Switzerland, 2016, p. 206.

individual trading partner of ASEAN, with a 14 percent share of ASEAN's trade in 2013.<sup>141</sup>

In a nutshell, since the Asian financial crisis policies implemented by China to eliminate all obstacles to its economic growth have given positive results. At first, China's willingness to have close relations with the ASEAN countries was not welcome. However, China's strong economy has started to be seen as an opportunity by them in their economic development. In addition, with the help of China's aforementioned initiatives to show its good intentions, ASEAN countries perception has changed in a positive way. With ACFTA, RCEP and One Road One Belt project, China and ASEAN countries have strengthened their economic relations. Notwithstanding, small Southeast Asian countries still have a lot to fear in economic terms. They have concerns due to the increasing interdependence on China as it makes costly to break economic relations. In order to examine this at a close range, the next section covers China's economic relations with the Philippines and Vietnam separately from 2000 to 2017 in detail. It analyzes economic relations of China-the Philippines and China-Vietnam by dividing it into three parts, namely trade relations, foreign direct investment trends and financial cooperation.

## **2.2. ECONOMIC INTERDEPENDENCE BETWEEN CHINA AND SOUTHEAST ASIAN COUNTRIES**

### **2.2.1. Trade Relations**

#### **2.2.1.1. China-The Philippines Trade Relations**

The Philippines is one of the poorest countries in Southeast Asia. Therefore, one of the main foci of its leaders has been economic development rather than foreign policy issues. The country has supported friendly relations with other countries and in this way was trying to avoid any kind conflicts in order to abstain from any clash between its economic and security interests. As Neoliberals claim, countries with weak economies tend to compensate when they engage in economic cooperation with a stronger country and also condone security issues. In this regard,

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<sup>141</sup> Salidjanova and Koch-Weser, p.6.

in the 2000s, the Philippines put away its territorial disputes and developed its economic relations with China.

The Philippines started to follow “development diplomacy” strategy which focuses on economic development and poverty mitigation. The country’s decision to cooperate with China in economic field can be seen as a part of this strategy. The Philippines considered China as a potential partner after its economic rise. Under CAFTA, the Philippines also became a part of “Early Harvest” program of China in 2005.<sup>142</sup> Therefore, in China- the Philippines economic relations “a golden age” started after 2005. In the framework of CAFTA, both countries removed trade barriers and this situation facilitates increase trade volumes and FDI flows. Correspondingly, the Philippines have had a chance to upgrade its industrial structure and increase the efficiency of its economy.<sup>143</sup>

Related to positive effect of FTAs in trade volumes, with the free trade area the total trade of the Philippines and China has risen dramatically. The Philippines total trade with China increased from 1.4 to 13 percent and China’s export share in the Philippines economy rose from 1.1 to 17 percent. China has become the fifth trading partner of the Philippines and their economic relations continued to improve with the Philippines positive approach. As it can be understood from Arroyo, the former president of the Philippines, remarks “In our administration, we have made the choice very clearly, we have embraced the opportunity to become China’s stronger partner”.<sup>144</sup>

In addition to domestic and regional factors, globally, both countries’ positions in the world economy also played a significant role behind two countries’ collaboration. The Philippines occupied 10 percent of the world’s semiconductor manufacturing, while China with its economic rise became an assembly hub. As a result, China became an important destination for electronics export of the Philippines in 2008. The Philippines’ exports of intermediate goods are assembling into final goods in China and this is the reason for defining the Philippines as a “factory”. Electronics constituted 54 percent of exports to China in 2011.

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<sup>142</sup> “List of Bilateral Agreements between the Philippines and China”, **ABS-CBN News**, 14.03.2008, <http://news.abs-cbn.com/special-report/03/14/08/list-bilateral-agreements-between-philippines-and-china>, (15.03.2017).

<sup>143</sup> Zeng, p.7.

<sup>144</sup> Solingen, p.25.

The Philippines is an intermediate input producer in the international production network due to its so called “factory” economy.<sup>145</sup> The intermediate inputs of the Philippines have great importance for China to maintain its production cycle.<sup>146</sup> With China’s economic rise in the early 2000s, China developed its trade relations with Philippines and jumped from 11<sup>th</sup> to 7<sup>th</sup> largest resource in import, and reached the third position in 2013 both in imports and exports. When Hong Kong is included with China, it constitutes 21 percent of Philippine exports, higher than exports to Japan and the US (with Japan at 19 percent and the US at 14.2 percent) which would make China its largest trading partner in 2011.<sup>147</sup> The top export and import destination of the Philippines was China with 19 billion \$ export and 13.8 billion \$ import in 2015.<sup>148</sup>

Philippines trade-to-GDP ratio was 63%<sup>149</sup> and while 17% of it consists of its import from China, 24% of it was its export to China.<sup>150</sup> 32% of the Philippines’ exports, which is the highest share among other countries where the Philippines export, to China consist of metals, minerals and fuels. 33% of the Philippines import from China consists of machinery and electrical products.<sup>151</sup>

**Table 2:** China’s Trade with the Philippines (US\$ million)

Year	2003	2005	2007	2009	2011	2013	2015
Export	3.09	4.6	7.5	8.5	14.2	19.8	21.6
Import	6.3	12.8	23	11.9	17.9	18.2	11.4
Balance	-3.1	-8.1	-15.6	-3.3	-3.7	1.6	5.2

Source: Salidjanova and Koch-Weser, p.26

<sup>145</sup> Abe Shigeyuki, “Competitiveness and Global Financial Meltdown: A Question of Japan’s Role”, **Center for Contemporary Asian Studies**, No. 22, 2009, p.7.

<sup>146</sup> Shigeyuki, pp.8-9.

<sup>147</sup> Darren James Lim, **Commerce with Competitors: Economic Interdependence, Vulnerability and Security Policy**, ProQuest LLC, the United States of America, 2014, pp.129-130.

<sup>148</sup> “Philippines”, **The Observatory of Economic Complexity**, <http://atlas.media.mit.edu/en/profile/country/phl/#Imports>, (15.03.2017).

<sup>149</sup> The World Bank, <http://data.worldbank.org/indicator/NE.TRD.GNFS.ZS?end=2015&locations=PH&start=2000&view=chart> (15.03.2017).

<sup>150</sup> “Philippines”, **The Observatory of Economic Complexity**, <http://atlas.media.mit.edu/en/profile/country/phl/#Exports>, (15.03.2017).

<sup>151</sup> Salidjanova and Koch-Weser, p.26.

The numerical data in the table below show that, from 2003 onwards, China's trade with the Philippines has been steadily increasing in both imports and exports. It can be also understood that more than half of the Philippines GDP comprise of its export and import with China. Therefore, in the case of a disruption in the Philippines exporting opportunities with China might originate a decrease in GDP of the country which means also a decrease in international purchasing power. In addition, it would be an obstacle for the economic development strategies of the country.

The party that will be adversely affected by this situation is not only the Philippines because any disruption in the Philippines-China economic relations might be costly for both sides. China supplies raw materials and fuels from the Philippines which is vital for China due to its huge need of them for the maintenance of production. As Rocky G. Dimaculangan, the Vice-President for Communications of the Chamber of Mines of the Philippines, puts it, “as mineral exports are prime and essential components to the industrialization program of China, we remain optimistic that they will not be covered by restrictions.”<sup>152</sup> More precisely, the lack of minerals is risky for China's economy.

However, China with its huge economic size and potential has larger influence on the Philippines economy than Philippines' effect on Chinese economy. In 2011, the Philippines stood outside China's top trading partners and the effect of the trade on China's GDP was less, yet the effect of trade with China on the Philippines GDP was ten times larger.<sup>153</sup> Neoliberal point of view and the data given above suggest that there is asymmetrical interdependence between the Philippines and China due to having different power and material capabilities thus the Philippines is relatively more vulnerable.<sup>154</sup>

Among recent developments that played an important role in deepening the economic relations of the parties there is China's One Road One Belt project. It has two parts, and the Maritime Silk Road part of it is directly related with the Philippines, because its route goes through the South China Sea-the Indian Ocean

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<sup>152</sup> “China barrier unlikely”, **Business World**, 17.05.2012, <http://www.bworldonline.com/content.php?section=TopStory&title=china-barrier-unlikely&id=51865>, (15.03.2017).

<sup>153</sup> Lim, p.118.

<sup>154</sup> Lim, p.117.

and the South China Sea-the South Pacific.<sup>155</sup> As the project aims to increase the connectivity among countries via sea-route to strengthen trade and infrastructure network for economic integration, the Philippines has become important link for China under its economic diplomacy. In the framework of the Maritime Silk Road, both sides signed many agreements<sup>156</sup> on economic cooperation in 2017.

With the Philippines-China economic relations explained, it is now possible to cover Vietnam-China economic relations. The next section addresses the trade relations of Vietnam and China to show the interdependence and asymmetry they have. It also analyzes their trade patterns and their relative positions in each other's economy.

#### **2.2.1.2. China-Vietnam Trade Relations**

Vietnam's economy has firmly become depend on China for its growth and stability. In the early 1990s, Vietnam considered Japan and ASEAN as its major trading partners.<sup>157</sup> However, this situation changed after China-Vietnam reestablished their diplomatic relations, which were damaged due to complex history of interactions and the perceptions of both sides during the Third Indochina War of 1978-1991.<sup>158</sup> The improvements in diplomatic relations has been complemented with improvements in the economic realm.

Developments in bilateral economic cooperation through trade agreements brought an increase in trade and investment on both sides. Annual percentage of trade between parties progressively increased except for the period of 1997 financial crisis. When trade value of China-Vietnam trade \$7.23 million in 1990, this reached to \$1218.14 million in 1999.<sup>159</sup>

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<sup>155</sup> Tricia Aquino, "How the Philippines can benefit from China's plan to revive the ancient Silk Road route", **Interaksyon**, 27.08.2016, <http://interaksyon.com/business/131857/how-the-philippines-can-benefit-from-chinas-plan-to-revive-the-ancient-silk-road-route>, (26.03.2017).

<sup>156</sup> Pia Ranada, "PH, China sign coast guard cooperation pact, 12 other deals", **Rappler**, 20.10.2016, <http://www.rappler.com/nation/149774-ph-china-sign-coast-guard-cooperation-pact>, (26.03.2017).

<sup>157</sup> Joseph Y. S. Cheng, "Sino-Vietnamese Relations in the Early Twenty-First Century," **Asian Survey** Vol.51, No. 2, 2011, p.392.

<sup>158</sup> Joseph Y. S. Cheng, "Sino-Vietnamese Relations in the Early Twenty-first Century: Economics in Command?" **Asian Survey**, Vol. 51, No. 2, 2011, p. 379.

<sup>159</sup> Rodolfo C. Severino, **ASEAN**, ISEAS Publications, Singapore, 2008, p.43.

In the post-normalization process between the years 2000-2009, the economic relations of China and Vietnam were the most dynamic. The total value of trade between them gradually increased during this period of time. After the recovery of the negative effects of Asian financial crisis, annual percentage of trade volume of Vietnam with China reached to remarkable amounts. Only \$2.9 billion in 2000, it increased to \$20 billion in 2009.<sup>160</sup>

Similar to the Philippines, there was a China-Vietnam initiative to fasten CAFTA and move further by committing to reduce import tariffs and abolish them completely by 2008 in the framework of “Early Harvest” program in 2001.<sup>161</sup> These tariff reductions led Chinese enterprises to increase the extent of their market share in Southeast Asia and specifically in Vietnam. Also, CAFTA provided many benefits to Vietnam’s economy. The elimination of trade barriers led to increased FDI flow into the country and increases in trade volumes with China.<sup>162</sup>

Both China and Vietnam have continued to take steps to improve their economic relations. China gave support to Vietnam during its accession to WTO and confirmed it with the Joint Declaration between Socialist Republic of Vietnam and People’s Republic of China in 2001. Later on, both sides signed Vietnam–China Joint Communique, and recognized each other as being “market economies” in 2004. In this year, the framework agreement on oil cooperation within the agreed area in the Gulf of Tonkin led Vietnam to import energy resources easily from China. They took step forward in developing bilateral economic ties with “two corridors, one belt” initiative, which aimed to connect five cities near the China-Vietnam border and improve infrastructure of this area in 2006. With the realization of this initiative China found a trade hub for its goods and commodities entering the ASEAN sphere.<sup>163</sup>

Among recent developments, as previously mentioned, there is China-Vietnam collaboration under the One Road One Belt project of China. For this Chinese project Vietnam has significance due to its location. The country stands at a key intersection for two proposed trade corridors of the project; thus, it plays an

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<sup>160</sup> Ngoc, pp. 194-196.

<sup>161</sup> Ngoc, pp.97.

<sup>162</sup> Zeng, p.5.

<sup>163</sup> Kim, pp.199-201.



important role in the transportation of the products produced in China to local markets.<sup>164</sup> Through this project, in recent years the two countries have continued close economic relations.

As a result of all these aforementioned developments, since 2006, China-Vietnam trade has continued to rise. Vietnam's trade with China in 2006 was 9.6 billion \$, this number dramatically increased to 50 billion \$ in 2013. China has become Vietnam's number one trading partner, constitutes 19 percent of Vietnam's total trade, 10 percent of Vietnam's export, 28 percent of its imports in 2013.<sup>165</sup> In 2014, the country's trade with China reached to 58 billion \$. As a result China has continued to be the biggest trading partner of Vietnam, while Vietnam became the second trading partner of China among ASEAN countries.<sup>166</sup>

**Table 3:** China's Trade with Vietnam (US\$ million)

Year	2003	2005	2007	2009	2011	2013	2015
Export	3.1	5.6	11.9	16.3	29	48.5	19.2
Import	1.4	2.5	3.2	4.7	11	16.8	49.8
Balance	1.7	3	8.6	11.5	17.9	31.7	-30.6

Source: Salidjanova and Koch-Weser, p.29.

In analyzing their trade patterns, goods which Vietnam exports to China mostly consist of raw materials such as rice, coffee, seafood, oil, coal and metal ore. Therefore, Vietnam has a comparative advantage on mineral and agricultural products. In return, China supplies to Vietnam with agricultural products, machinery for light industry, hydropower stations and transportation vehicles. China's exports to Vietnam were twice more than Vietnam's export to China. This trade deficit is because the products that Vietnam are exporting are low value added. While Vietnam exports raw materials, agricultural and wooden products to China, it imports petroleum products, iron and steel. Until now, there was no change in the trade patterns and China remained as the manufacturing resources supplier for Vietnam

<sup>164</sup> Benny Hui, "China's One Belt One Road Initiative – Vietnam", **Spacious Hong Kong**, 18.11.2016, <https://www.spacious.hk/en/blog/chinas-one-belt-one-road-initiative-vietnam/> (26.03.2017).

<sup>165</sup> Ngoc, p.201.

<sup>166</sup> Ngoc, p. 201.

and largest market for Vietnam's raw materials and agricultural products. Their trade relation shows that there is complementarity in product categories. As this is fundamental for intra-industry trade, Vietnam and China are closely linked in an international production chain.

Vietnam's share in Chinese economy is not as much as China's share in their economies. In 2013, Vietnam constituted 1.2% of China's trade; however, China's share covered 19% of Vietnam's trade. This situation exemplifies the increasing dependence of Vietnam on China. Yet, this does not prove that China is not dependent on those countries, as there is a trade relation between them. If there were no mutual benefits, there would not be trade.

In this section trade relations of the Philippines-China and Vietnam-China are outlined concisely. To understand the effect of another factor in the evolvement of the Philippines-China and Vietnam-China economic relations to interdependence, the discussion frames their investment trends in detail. It covers China's foreign direct investment motivations to Vietnam and the Philippines and explains the effects of them to these countries' economies separately.

### **2.2.2 Foreign Direct Investment**

Concerning the literature on investment, "South-South" foreign direct investment among other different investment trends is the most appropriate to explain the investment relationship between China and Southeast Asian countries. After Southeast Asian countries financially liberalized in the 1990s, their companies started to invest abroad. China's advantage are derived from the proximity of its geographical location to those countries, its low labor costs and huge domestic market drew their attention for investment. While the Philippines has invested<sup>167</sup> in China for a small amount, Vietnam as a developing country has almost no investment in China. However, China's strong economy means that its outward

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<sup>167</sup> The Philippines has made noteworthy investment into China, despite the lower-middle-income status of that country. The investors include the snack food company like Oishi and real estate businesses which specializes in mixed-use developments such as condominiums, shopping malls, and hotels. The Philippines invested \$2.78 billion in China in 2010 and \$125 million in 2011. The Philippines investment into China rose 4.2 percent and reached to \$96.99 billion by 2016.

investments to the Philippines and Vietnam are greater than theirs into China; thus, Chinese dominance in those countries is inevitable.<sup>168</sup>

While analyzing the interdependence of China and its Southeast Asian neighbors in FDI terms, one must consider the factors behind China's outward FDI motivations. As an export-oriented growing economy with increasing production rate, China's need for the necessary raw materials used in the production process has increased. Therefore, China has had to source these raw materials from its closest neighbors with less transportation cost consideration. Although China has many trade partners all around the world and access to broad markets, its increasing production rate seeks access to wider markets. In this regard, the number of countries receiving Chinese FDI has increased year by year.

In line with China's FDI motivations, there are two kinds of investments in this study, which are Vietnam and the Philippines. First, China's investment type is resource-seeking investment aimed at searching for unique resources specific to foreign locations. Therefore, China's FDI to less developed Vietnam and the Philippines with rich natural resources can be explained in this context. Second, market-seeking investment aimed at entering into new markets.<sup>169</sup> Its FDIs to the Philippines and Vietnam is also related with those countries size of market and their access to global markets through ASEAN. Also, China has export relations with these countries; thus, FDI is aimed to ensure support for Chinese exporting firms.

Chinese outward investment includes corporation-to-government enterprises<sup>170</sup> which means that Chinese investors are working with state agencies of the host country and there are economic arrangements between state agencies and private Chinese companies.<sup>171</sup> China's motivation for corporation-to-government enterprises is to make resource-seeking investment which aim to search for unique resources specific to foreign locations. Therefore, China's FDI to less developed

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<sup>168</sup> Krislert Samphantharak, "The Rise of China and Foreign Direct Investment from Southeast", **Journal of Current Southeast Asian Affairs**, Vol.30, No. 2, 2011, p.3.

<sup>169</sup> Kefei You and Offiong Helen Solomon, "China's outward foreign direct investment and domestic investment: An industrial level analysis," **China Economic Review**, Vol. 34, 2015, p.254.

<sup>170</sup> "Contentious Capital and the Political Economy of Chinese Investment in the Philippines", **ADR Institute for Strategic and International Studies**. Vol.9, No.11, 2016, p.5.

<sup>171</sup> ADR, p.6.

Vietnam and the Philippines with rich natural resources can be explained in this context.<sup>172</sup>

The motivation of Vietnam and the Philippines as developing countries is different. In comparison to developed countries, developing countries are insufficient in terms of capital resources and have limited access to international financial markets. Yet, capital accumulation is the most necessary thing to achieve economic growth. Therefore, developing countries consider FDI as an alternative source of capital and try to attract more FDIs. In addition to capital support, FDI makes significant contributions to the development of the host country in many aspects such as technological advancement, broaden marketing network, better management skills, and so on.<sup>173</sup> Consequently, it is a priority of both Vietnam and the Philippines to make an effort to attract more FDIs.

#### **2.2.2.1. Chinese Investment into the Philippines**

The Philippines have implemented many reforms for changing its investment policies to benefit from the contributions of FDI into its economy since the 1990s. Important steps have been taken to liberalize investment policies with several changes and improvements in regulations<sup>174</sup> for removing barriers to foreign investment entry.<sup>175</sup> As a result of these reforms, it has managed to attract more investment.

China's investments in the Philippines have been on a gradual rising line since the 2000. When the stock of Chinese FDI in the Philippines was 9 million \$ in 2003 and 692 million \$ in 2013, it reached to 4.68 billion \$ in 2016.<sup>176</sup> 23% of FDI sources of the Philippines constitute Asian countries and 21% of it came from China (with

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<sup>172</sup> You and Solomon, p.255.

<sup>173</sup> Santos, p.8.

<sup>174</sup> Those steps can be listed as the Foreign Investment Act (FIA) of 1991, operations of foreign banks were liberalized in 1994, Republic Act 7916 of 1995, the General Banking Law of 2000. Hazel C. Parcon-Santos, "Trade and Investment in the Philippines", **Center for Monetary and Financial Policy Bangko Sentral ng Pilipinas**, pp.8-9.

<sup>175</sup> Parcon-Santos, p.7.

<sup>176</sup> Salidjanova and Koch-Weser, p.4.

Hong Kong).<sup>177</sup> Therefore, with its increasing amount of investment, China is ranked among the top five investor countries in the Philippines.

China invests in the Philippines in various sectors, with the most prominent being agriculture and mining. China invested 4.9 billion \$ in the Philippines agricultural sector in 2012. For instance, China's Fuhua Group invested 3.8 billion \$ to set up ethanol and bioethanol plants. Chinese companies are also influential on mining industry of the Philippines by becoming a major customer of the country's mining products.<sup>178</sup>

**Table 4:** Value of China's FDI to the Philippines (US\$ million/billion)

Year	2003	2005	2007	2009	2011	2013	2016
	8.75 million	19 million	43 million	143 million	494 million	692 million	4.68 billion

Source: CEIC, <https://www.ceicdata.com/en/indicator/philippines/foreign-direct-investment>, (05.04.2017).

Under its "pro-Filipino" policy, the Philippines has shown interest in developing regional economic relations with China with more loans and business.<sup>179</sup> In the framework of the Maritime Silk Road project, China seeks to develop infrastructure capacity of the Philippines thus providing fund and making investments to the country through AIIB which China has 30% equity.<sup>180</sup> There are flood management, metro system and rapid transit system projects which will be realized with financial support of AIIB.<sup>181</sup> Ultimately, China and the Philippines agreed to cooperate on 30 projects worth 3.7 billion \$ and China also stipulated 15 billion \$ of investment in the Philippines in 2017.

<sup>177</sup> Foreign Direct Investment in the Philippines, <https://pinnacle.ph/research/foreign-direct-investment-philippines>, (05.03.2017).

<sup>178</sup> Tom K. Stern, "Chinese Investments in the Philippines", *the Journal of Political Risks*, Vol. 4, No. 6, 2016.

<sup>179</sup> "China, Philippines agree to cooperate on 30 projects worth \$3.7 billion", *CNBC*, 27.01.2017, <http://www.cnbc.com/2017/01/23/china-philippines-agree-to-cooperate-on-30-projects-worth-37-billion.html>, (05.03.2017).

<sup>180</sup> Adoracion M. Navarro, "The AIIB offers hope for the China-Philippines relationship", *East Asia Forum*, 20.07.2016, <http://www.eastasiaforum.org/2016/07/20/the-aiib-offers-hope-for-the-china-philippines-relationship/>, (25.03.2017).

<sup>181</sup> Finbarr Bermingham, "AIIB to fund Philippines projects", *Global Trade Review*, 22.12.2016, <http://www.gtreview.com/news/asia/aiib-to-fund-philippines-projects/>, (25.03.2017).

The Philippines is a developing country and contribution of FDI to its economy is remarkable. Except from positive effect on economic growth, it also provides employment to exemplified, in the next five years the number of jobs which Chinese FDI created will reach to 2 million.<sup>182</sup> By improving infrastructure through FDIs in long term, the country will maintain its attractiveness for investment and maintain economic development.

#### **2.2.2.2. Chinese Investment into Vietnam**

China is one of the most significant investors for Vietnam, with continuously growing investment volume since 1991. The investments made by China in the 1990s were generally small-scale and did not require superior technology and were only made in order to meet the needs of ordinary consumers. Except from two projects aimed at the development of industrial zones in Ho Chi Minh City and Hai Phong worth 14 million \$ and 15.5 million \$, other projects that China invested in were worth less 1 million \$.<sup>183</sup> Therefore, there was no worthwhile impact of these investments on Vietnam's socio-economic development during 1991-2001.

However, China had 110 projects with total registered capital of 221 million US \$ in 2001. After China's accession to WTO in 2001 and the Framework Agreement on Comprehensive Cooperation ASEAN-China in 2002 China's FDI in scale and the number of projects have increased. Meanwhile, China's contribution to Vietnam's development has begun to show its effect since 2002. Vietnam's accession to WTO accelerated its integration with the world economy and improved its capability to attract investment in 2007. As a result, Chinese FDIs have dramatically increased and the average capital of a project has reached up to 4.3 million US \$.

From 2011 to 2014, a most fascinating change in China's FDI in Vietnam occurred as 110 new projects worth 2.3 billion \$ were accepted. One of those projects is the BOT coal-fired power plant Vinh Tan 1 projects in Binh Thuan province attracted 2,018 billion US \$ from Chinese investors. In addition to the Vinh Tan 1 projects, there were other projects in several areas such as real estate,

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<sup>182</sup> Amy R. Remo, "Itemized list of PH projects covered by China's \$15-B investment pledges to Duterte", *Inquirer*, 23.10.2016, <http://business.inquirer.net/217269/itemized-list-ph-projects-covered-chinas-15-b-investment-pledges-duterte>, (26.03.2017).

<sup>183</sup> Ngoc, p.200.

industrial and textiles. In 2013, through these projects China took fourth place among 101 countries in investing in Vietnam.

**Table 5:** Value of China's FDI to Vietnam (US\$ million/billion)

Year	2003	2005	2007	2009	2011	2013	2015	2016
	28	229	397	729	1.2	2.3	1.3	1.8
	million	million	million	million	billion	billion	billion	billion

Source: CEIC, <https://www.ceicdata.com/en/indicator/vietnam/foreign-direct-investment>, (05.04.2017).

It was very profitable for Chinese investors to make investment in Vietnam mostly in terms of raw materials. As Vietnam is a party of Trans Pacific Partnership (TPP) and EU-Vietnam Free Trade Agreement tax rate was 0 %; thus, there was an increase in investment capital projects. Chinese investors invested in Vietnam in 17 industries such as processing, manufacturing, electricity, construction etc.<sup>184</sup> Furthermore, owing to the key position of Vietnam in the One Road One Belt project, China plans to invest in developing its infrastructure, specifically railways, seaports and highways with. In this regard, China and Vietnam have signed many bilateral agreements on connecting economic infrastructure in 2017.<sup>185</sup>

Similar to the Philippines, Vietnam as a developing country has huge need for FDI to make progress in industrialization of its economy and its economic growth. Therefore, FDI have an important role in Vietnam's economy. For instance, in 2000 Chinese FDI created 53.000 jobs in Vietnam and led an increase in income of labors. In 2010 this number reached to 200.000 with the increasing number of new investment projects.<sup>186</sup> In the process of improving its infrastructure, reinforcing economic growth and handling capital shortage Chinese FDI contributions have played crucial roles for Vietnam. They provided assistance in employment creation and improvement the capacity of workers. It has also helped Vietnam to increase its

<sup>184</sup> Nguyen Dinh Liem, "China FDI in Vietnam after Twenty Years", **Vietnam Social Sciences**, No.6, 2015, p.21.

<sup>185</sup> "AIIB eyes infrastructure development in Viet Nam", **Viet Nam News**, 27.01.2017, <http://vietnamnews.vn/economy/349672/aiib-eyes-infrastructure-development-in-viet-nam.html#d2lmbEPdGF3BkiH2.97>, (25.03.2017).

<sup>186</sup> Liem, p.25.

exports and export markets, because FDI allowed Vietnamese goods to reach China and other Asian markets. Additionally, it contributed the integration of Vietnam's economy to the world economy and has the attention of other regional or global investors.

Having shown the leading motivations of the Philippines and Vietnam for FDI and its impact on their developing economies, next section puts forth the effect of the final indicator on these countries' economic interdependence with China. While doing so, their financial cooperation is analyzed in further depth.

### **2.2.3 Financial Cooperation**

Southeast Asian countries have taken their lessons from 1996 Asian Financial Crisis. Therefore, in the process of their financial integration, they have taken many initiatives in order to eliminate the destructive effects of financial crisis on their weak economies. Nevertheless, the more they become financially connected through different platforms and financial arrangements, the more their economies have become interdependent. Financial connections, banking relations and currency swaps have undeniable effects on interdependence. Therefore, this section, which is also last section of this chapter, briefly analyzes the financial cooperation between China-the Philippines and China-Vietnam.

Financial cooperation of these countries started after the Asian financial crisis. Therefore, the 1997 financial crisis can be considered as the origin of the financial interconnectedness in Asia. Due to its devastating effect on most of the economies in Asia, countries began to be prone to take steps for regional financial arrangements.<sup>187</sup> Growing export and import relations necessitated financial stability and steady economies in Asia and this led interrelated financial, investment and banking relations among countries which take part in these arrangements. The economic interdependence between these countries has gained a different dimension in terms of financial cooperation platforms with the emergence of interdependence in financial aspects.<sup>188</sup>

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<sup>187</sup> Giap, p.4.

<sup>188</sup> James R. Masterson, pp. 310-314.



Most Asian countries suffered from the 1997 Asian financial crisis due to its negative effects on their economies and currencies. There were inconsistencies between their exchange rates and the foreign exchange market due to the decline of the value of their currencies against the US dollar. The decrease in foreign exchange rate led problems for the domestic firms which borrowed money abroad in dollar because paying back the loans became difficult for them, as the borrower firms needed to earn more in their local currencies.<sup>189</sup> Therefore, with the aim of ensuring regional financial stability and to prevent incoming financial problems, many regional financial cooperation platforms have been established, in which China and Southeast Asian countries are involved. First, the formation of the Asian Bond Fund aimed to make it possible to borrow long-term money from other Asian economies and with this way their economies would be less vulnerable against Western investors' actions. This development led to the creation of an agreement within a new regional group, the so-called the Executives' Meeting of East Asia-Pacific Central Banks (EMEAP) in 2003.<sup>190</sup>

Second, the Chiang Mai Initiative (CMI) consists of swap agreements among all ASEAN member countries and a network of bilateral currency swap and repurchase arrangements among ASEAN+3 (China, Japan, South Korea) countries in 2000. The main motivation behind the CMI was stabilizing currencies while achieving overall financial stability in the region and monitoring capital flows.<sup>191</sup> With this initiative, regional economies decided to help and support each other through a network of currency swaps.<sup>192</sup> China, as the only country which was not affected by the crisis, played an important role as the lender in this network. For instance, under the framework of CMI, China and the Philippines signed a bilateral swap agreement in 2003. China provided to the Philippines 400 million \$ preferential

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<sup>189</sup> Edward J. Lincoln, "The Asian Regional Economy", **International Relations of Asia**, (Ed. David Shambaugh and Michael Yahuda), Rowman and Littlefield Publishers, the United States of America, 2008, pp.291-292.

<sup>190</sup> Lincoln, pp.295-297.

<sup>191</sup> Jenny D. Balboa and others, "Closer Trade and Financial Cooperation in ASEAN: Issues at the Regional and National Level with Focus on the Philippines", **Philippine Institute for Development Studies**, 2007, No.3, p.4.

<sup>192</sup> Das, p.1091.

buyers' credit from the Export-Import Bank of China. In that arrangement, there was a swap of foreign exchange reserve from one country's central bank to the other's.<sup>193</sup>

Third, in 2003 China developed a proposal to "propel the bilateral swap agreements into a multilateral Chiang Mai Initiative"<sup>194</sup> because since the beginning China demonstrated willingness to evolve CMI into a multilateral mechanism.<sup>195</sup> They could not make any progress about this till the 2008 global financial crisis. With the crisis, Asian countries' concerns about regional financial stability raised again. In 2009, ASEAN+3 countries signed the Chiang Mai Initiative Multilateralization (CMIM) Agreement to establish the Asian foreign reserve pool with the purpose of overcoming the short-term liquidity difficulties and providing assistance to member countries.<sup>196</sup>

During the 2008 global financial crisis, many Southeast Asian countries faced with liquidity problems since their central banks did not have dollar reserves to cover the demands of traders. Yet, China's foreign reserves were dramatically increasing and by 2010 China possess one-third of the world's total reserves thus it stood out of the liquidity problems. China did not share the same motivation as its neighbors for creating foreign reserve pool, as the Chinese economy would not be affected by a probable crisis. This has given China a chance to support its neighbors financially and has a strong position in financial platforms they created.

## **2.2.CHAPTER CONCLUSION**

China, with its economic transformation and rapid economic growth in a short time, became an important economic power of Asia. After its accession the World Trade Organization (WTO) in 2001, it started to deepen its economic relations with its neighbors. The country became the largest trading partners of almost every state in Southeast Asia and an important supplier of foreign investment. Intertwinement of economies in Asia supported by many bilateral and regional Free Trade Agreements (FTAs). This paved the way increasing economic interdependence

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<sup>193</sup> Lincoln, pp.294.

<sup>194</sup> Wen Jin Yuan and Melissa Murphyreg, "Regional Monetary Cooperation in East Asia Should the United States Be Concerned", **the Center for Strategic and International Studies (CSIS)**, 2010, p.2.

<sup>195</sup> Yuan and Murphyreg, p.2.

<sup>196</sup> Yuan and Murphyreg, p.3.

between China and Southeast Asian countries. This chapter uses trade, FDI and financial cooperation as indicators to measure economic interdependence between China-the Philippines and China-Vietnam put forth how parties are economically depending on each other in detail.

By comparison, China's influence on the economy of the Philippines is substantial. China as a regional economic power in Asia, in size and economic potential, is stronger. In contrast, the Philippines have relatively a weaker position as a developing country. The outcome of free trade agreement is more beneficial for the Philippines as a small country than China. However, it led the Philippines to have a dependent position. In 2011, the Philippines stood outside China's top trading partners and the effect of the trade on China's GDP was less, yet the effect of trade with China on the Philippines GDP was ten times larger.<sup>197</sup> Therefore, China has more preference than the Philippines in their economic relations. Keohane and Nye in their book "Power and Interdependence" expressed this situation with a concept known as "asymmetrical interdependence".<sup>198</sup> The Neoliberal point of view and the data given above suggest that there is asymmetrical interdependence between the Philippines and China due to differing power and material capabilities; thus, the Philippines is relatively more vulnerable.<sup>199</sup>

Similar to the Philippines, Keohane and Nye's concept of asymmetrical interdependence is the ideal term to express the relation between Vietnam and China. From Neoliberal perspective, it is possible to state that there is an undeniable asymmetrical interdependence between China and Vietnam due to having different economic capacities. This asymmetry favors China as Vietnam's market is dependent on Chinese market for its economic growth and stability. Vietnam was isolated from technological development and economic modernization because while it was providing raw material to China, in exchange it was receiving China's out-of-date technology. Despite Vietnam has followed China's reform process and development with its "Doi Moi" (renovation) policy, it could not close the gap between China's development and capacity; thus, asymmetry has continued to increase.

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<sup>197</sup> Lim, p.118.

<sup>198</sup> Robert O. Keohane and Joseph S. Nye, "Power and Interdependence Revisited", **International Organization**, Vol. 41, No. 4, 1987, p.728.

<sup>199</sup> Lim, p.117.

To put the effect of FDI on economic interdependence of China-the Philippines and China-Vietnam more explicitly, in this framework, Chinese FDI is vital importance for both countries' economies. In the absence of Chinese investments, the economic growth of these countries would be interrupted, as they both have fragile economies and a huge need for capital flow. In the long run, the consequences of this interruption would be reflected also in political domain besides economic one. For instance, removal of Chinese FDIs would create unemployment and cause problems also in domestic politics, in the sense that the decrease in public support will weaken the power of the government. As probable economic based problems are not welcomed, they will try to eliminate the problems and prevent any disruptions in their FDI flow. This point consolidates the assumption that there is economic interdependence between China-Vietnam and China-the Philippines.

As expressed on this chapter in detail, through the initiatives in financial area China provide significant assistance to the Philippines and Vietnam since 1997 Asian financial crisis. China became a stabilizing force in the Asian financial system with investment, aids and swap agreements. This condition has increased the financial sensitivity of the Philippines and Vietnam as their banking relations have become intertwined with China. Moreover, bond markets are parallel to banking thus the maintenance of cooperation is needed for the continuation of stable growth of the Philippines and Vietnam. As those countries' national banks have funds and foreign aid from China, the cost of any disruption increases for them.

According to Neoliberal assumptions, when states become more interdependent economically, they are less likely to experience conflict. Also, they have many channels of contact and using military force for solving problems is not an option. As this chapter demonstrates, there is an undeniable economic interdependence between China-the Philippines and China-Vietnam. However, this study shows that when the expedience is high in terms of survival, interdependence has proven unable to force the Philippines and Vietnam into adopting security policies more accommodating of Chinese interests and it led to a conflict among them. To further this discussion, the next chapter will cover the security relations of China-the Philippines and China-Vietnam in the context of the South China Sea dispute.



### CHAPTER THREE

#### SECURITY RELATIONS IN THE SOUTH CHINA SEA DISPUTE

The South China Sea dispute is an important case which involves many of the Southeast Asian countries and China. The dispute is one of the most serious issues in the region as it has a potential to create diplomatic and military conflict between the parties.<sup>200</sup> Among the contenders, the bilateral tensions between China-the Philippines and China-Vietnam are widely regarded as most significant As none of the claimants forgo from their rights, there is an unsolved dispute among them for decades.

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<sup>200</sup> Tobias J. Burgers, “An Unmanned South China Sea? Understanding the Risks and Implications of the Arrival of the Digital and Robotic Revolution in Military Affairs in the SCS”, **Power Politics in Asia’s Contested Waters**, (Ed. Enrico Fels and Truong-Minh Vu), Springer, Switzerland, 2016, p.77.

To start with China, there are several reasons for the country's aggressive behaviors in these contested waters. China considers the issue as an internal matter concerns its national identity that having the control over the Sea may compensate Chinese humiliation by Western colonizers in the past. The South China Sea strategically important for China for the continuation of the country's economic development with its rich energy resources and plays an important role for China's territorial integrity and security. Therefore, China has used low-intensity coercion to maintain its existence and control in the Sea. In order to develop the capability to control the disputed area, the country made progress in enhancing its maritime capabilities. China developed its navy forces with high-level strategies, plans and policies to transform them into a more technologically advanced and flexible force for fighting and for winning.

Similarly, for the Philippines and Vietnam the South China Sea is related to their security, territorial integrity and most importantly their survival. In accordance with the "regime of islands" principle under the UN Convention on the Law of the Sea, the Philippines presented the geographical coordinates of its archipelagic baselines to the UN in 2009. Per the coordinates, the Scarborough Shoal takes place within the Philippines EEZ. Therefore, the priority of the Philippines is to protect its territorial right over the area. Also, the Sea is important for those countries with its rich energy resources and strategic significance. For the Philippines, the Sea became important due to an increase in its energy consumption. For Vietnam, similarly, oil drilling and fishing activities in the South China Sea are significant for the economy of the country. For Vietnam, securing its territorial claims is important for the sovereignty of the country. Therefore, both countries were not happy with China's restrictions, which prevent them from gaining the benefits of rich oil resources and oil exploration activities in the Sea.

By 2000s, China's presence had increased in the Sea with actions such as military modernization, island building activities and oil exploration activities. Both countries were alarmed with China's recent initiatives in the South China Sea as they threaten their sovereignty. Recently, with Scarborough Shoal standoff in 2012, the

Philippines' security concerns reached the breaking point.<sup>201</sup> With a small-scale skirmish with Chinese vessels in the disputed area in 2011, Vietnam's concerns have also increased.<sup>202</sup> Therefore, the Philippines and Vietnam's approach and actions toward China has shaped by security apprehension.

Prior to putting forth security relations of China-the Philippines and China-Vietnam in the South China Sea dispute, this chapter will cover the historical background of the dispute starting from 1950s. As mentioned previously, the Southeast Asian countries' "China threat" perception have two aspects. The second chapter covered the economic aspect of it and the first section of this chapter will cover the security aspect of it. Later, the chapter will combine it with the importance of the Sea for China and the country's activities in the disputed area including reclamation and construction activities. The chapter will also analyze the defense responses of Vietnam and the Philippines against Chinese aggression.

### **3.1. HISTORICAL BACKGROUND OF THE SOUTH CHINA SEA DISPUTE: SMALL ISLANDS, BIG PROBLEMS**

As the South China Sea is regarded as strategic for the countries in the region, the surrounding countries have fought to gain control of the area. However, the right of sovereignty in the South China Sea was not a serious debate or tension before the 20th century.<sup>203</sup> When World War II ended, Japan abandoned its claim to sovereignty over the area<sup>204</sup> and withdrew from the region in 1945. After that, control of the South China Sea transformed into a debate of sovereignty between China and neighboring countries in the region.

The disputed areas among China and the Southeast Asian countries consist of the Paracel Islands, Spratly Island and the Scarborough Shoal, in addition to the

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<sup>201</sup> Marc Lanteigne, "The South China Sea in China's Developing Maritime Strategy", **Power Politics in Asia's Contested Waters**, (Ed. Enrico Fels and Truong-Minh Vu), Springer, Switzerland, 2016, p.108.

<sup>202</sup> Tung Nguyen Vu, "Vietnam's Security Challenges: Hanoi's New Approach to National Security and Implications to Defense and Foreign Policies", **Security Outlook of the Asia Pacific Countries and Its Implications for the Defense Sector**, NIDS Joint Research Series No. 7, Japan, 2012, p.116.

<sup>203</sup> Alexandra Sakaki, "Keeping the Dragon at Bay: The South China Sea Dispute in Japan's Security Strategy", **Power Politics in Asia's Contested Waters**, (Ed. Enrico Fels and Truong-Minh Vu), Springer, Switzerland, 2016, pp.426-428.

<sup>204</sup> Sakaki, p.430.

South China Sea itself.<sup>205</sup> While China had claims over the whole South China Sea, the Philippines had over some part of Spratly Island such as Scarborough Shoal, Kalayaan Island Group and Mischief Reef.<sup>206</sup> In addition, Vietnam claims the Paracel Islands and some part of the Spratly Islands.<sup>207</sup> They all followed different ways to support their allegations. These ways are re-naming, mapping, occupying islets, protesting each other's actions, attacking and arresting fisherman.<sup>208</sup> To exemplify re-naming, the sea is called the "Southern Sea" in China, the "Eastern Sea" in Vietnam and the "West Philippines Sea" in the Philippines.<sup>209</sup>

They also supported their claims on historical and legal ground. For instance, China uses historical maps and evidences to show the islands were its traditional bases for fishing and trade vessels.<sup>210</sup> China claims the area encompassed by the so-called "nine-dash line" which covers 80-90 % of the South China Sea. The official version of "nine-dash line" is "traditional maritime boundary line" in China and it is also known as "the South China Sea nine-segment line".<sup>211</sup> To support its claims, China revealed historical maps issued in 1914 and configurations which included only Paracel and Pratas regions.<sup>212</sup> Additionally, China attempted to bolster its claims to the Kalayaan Islands by reference to maps drawn up 2,000 years ago by the Han Dynasty.<sup>213</sup>

The sovereignty claim of the Philippines on the Spratly Islands is based on a personal assertion that Captain Thomas Cloma, an adventurer and fishermen, discovered a group of islands in 1956 called the Kalayaan (Freedom) Islands in the South China Sea.<sup>214</sup> Thenceforward, the country has declared laws on archipelagic baselines and the geographic scope of its EEZ and put the Kalayaan Islands under the

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<sup>205</sup> Sigfrido Burgos Caceres, **China's Strategic Interests in the South China Sea Power and Resources**, Routledge, Oxon, 2014, p.13.

<sup>206</sup> Richard Javad Heydarian, "The US-Philippine-China Triangle: From Equi-balancing to Counter Balancing amid the South China Sea Disputes", **Power Politics in Asia's Contested Waters**, (Ed. Enrico Fels and Truong-Minh Vu), Springer, Switzerland, 2016, p.350.

<sup>207</sup> Tonnessan, p.201.

<sup>208</sup> Maria Ortuoste, "The Philippines in the South China Sea: Out of Time, Out of Options? ", **Southeast Asian Affairs**, 2013, p.240.

<sup>209</sup> David Scott, "Conflict Irresolution in the South China Sea", **Asian Survey**, Vol. 52, No. 6, 2012, p.1019.

<sup>210</sup> Lantaigne, p. 102.

<sup>211</sup> Burgers, p.8.

<sup>212</sup> Ian James Storey, "Creeping Assertiveness: China, the Philippines and the South China Sea Dispute", **Contemporary Southeast Asia**, Vol. 21, No. 1, 1999, p.96

<sup>213</sup> Storey, p.97.

<sup>214</sup> Ortuoste, p.241.



administrative jurisdiction of Palawan province.<sup>215</sup> Vietnam also has historical and legal evidence to demonstrate their sovereignty rights over the Paracel and Spratly archipelagoes. Similar to China, the country also came up with ancient documents such as maps, books and official papers from the early 17th century.<sup>216</sup> Similar to the Philippines, legally Vietnam's allegations are based on UNCLOS and the country considers the region to be within its EEZ.<sup>217</sup>

**Figure 3:** The South China Sea Map of Overlapped Territorial Claims



Source: <http://www.inquiriesjournal.com/articles/1339/competing-claims-in-the-south-china-sea-viewed-through-international-admiralty-law>, (20.05.2018).

Therefore, since the 1970s, there has been many conflicts between China-the Philippines and China-Vietnam due to their overlapping claims. Many conflicts occurred between China and Vietnam as their claims clash on the Paracel Islands in the 1970s.<sup>218</sup> Both countries were threatening each other's fishing boats in 1974 and it resulted in a conflict which China reacted with a military operation.<sup>219</sup> In 1988, another small-scale conflict occurred between China and Vietnam over the Johnson South Reef in the Spratly Islands in which Chinese naval forces clashed with

<sup>215</sup> Ortuoste, p.240.

<sup>216</sup> Tran Truong Thuy and Nguyen Minh Ngo, "Vietnam's Security Challenges: Priorities, Policy Implications and Prospects for Regional Cooperation", **The National Institute for Defense Studies**, 2011, p.95.

<sup>217</sup> Do Thanh Hai, "Vietnam: Riding the Chinese Tide", **The Pacific Review**, 2017, p.2.

<sup>218</sup> Lanteigne, p.100.

<sup>219</sup> Lanteigne, p.100.

Vietnam People's Navy.<sup>220</sup> In the case of the Philippines, similar clashes occurred over Spratly Island.<sup>221</sup> In 1994, China started to create installations on the Mischief Reef in the Spratly Islands, which is disputed with the Philippines.<sup>222</sup> The closure of the US military base in the Philippines in 1992 encouraged China for more assertive actions in the region.<sup>223</sup> As a result of these conflicts and aggressive attitude of China, the Philippines and Vietnam have regarded China as a threat for decades.

### 3.1.1. "China Threat" Conception of the Southeast Asian Countries

China is aware that this situation might have a negative effect on its economic relations with these countries and parallel to the continuation of the country's economic development. Therefore, China has taken many diplomatic and military initiatives to reassure Southeast Asian countries that no matter how strong China is, it will not threaten their interests.<sup>224</sup> First, China's diplomatic messages to its neighbors have changed and the country has reformulated the five principles of peaceful coexistence and came up with "New Security Concept" in 1997.<sup>225</sup> With this concept, China emphasized mutually beneficial cooperation on the basis of equality, respect, resolution of the conflicts through dialogues and non-interference in the internal affairs of its neighbors. With this reassurance, China also assured that it would not support ethnic or separatist groups.<sup>226</sup>

Furthermore, the country has taken measures to lower the security concerns of its neighbors. For instance, China made huge efforts to address all its land border disputes in 1990s.<sup>227</sup> This increased cooperation against terrorism and organized crime. China is aware that its rising military power is considered a potential threat by its neighbors. As a response to "military threat" perception of its Southeast Asian

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<sup>220</sup> Ramses Amer, "China, Vietnam, and the South China Sea: Disputes and Dispute Management", **Ocean Development and International Law**, Vol.45, No.1, 2014, p.20.

<sup>221</sup> Ndi, p.272.

<sup>222</sup> Zachary Abuza, "The Philippines Internal and External Security Challenges", **Australian Strategic Policy Institute**, No.45, 2012, p.12.

<sup>223</sup> Abuza, p.12.

<sup>224</sup> Saunders, p.132

<sup>225</sup> Elisa I. Hörhager, "China-ASEAN Relations and the South China Sea: Beyond Balancing and Bandwagoning?", **Power Politics in Asia's Contested Waters**, (Ed. Enrico Fels and Truong-Minh Vu), Springer, Switzerland, 2016, p.369.

<sup>226</sup> Hörhager, p.372.

<sup>227</sup> M. Taylor Fravel, "China's Strategy in the South China Sea", **Contemporary Southeast Asia**, Vol. 33, No. 3, 2011, p.298.

neighbors, China claimed that its increasing military power is necessary for peace and does not threaten any country.<sup>228</sup> Also, the country increased its transparency in terms of military issues and published its first white paper on arms control in 1995.<sup>229</sup>

Nevertheless, these initiatives were insufficient to change the threat perceptions of its southeastern neighbors as they have a strong historical basis. To start with the Philippines, its “China threat” perception can be explained by three main reasons, respectively: ideological fear, Taiwan Strait Crisis and territorial disputes in the contested waters.<sup>230</sup> First, ideological difference played an important role in the Philippines perception of China. In the Cold War era, as a non-Communist country the Philippines had the fear of the spread of the communism.<sup>231</sup> The country was faced with armed communist upheavals which were a threat to its domestic stability. Therefore, it was determined to stop communism from spreading into its lands at all costs.<sup>232</sup> As there was a suspicion that China was providing support to local communist rebels, the Philippines began not to trust China.<sup>233</sup>

Second, the Philippines approach to China has changed after China’s Cross-Strait military actions. In 1996, PLA conducted military exercises and launched several short-range ballistic missiles tests into the waters off Taiwan.<sup>234</sup> Similar to other Southeast Asian countries, the Philippines has given a significant attention to China’s belligerence.<sup>235</sup> As there is an unequal distribution of power between China and the Philippines, knowing that China could use force without hesitation when it is about its interest increased “China threat” feeling of the country.

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<sup>228</sup> M. Taylor Fravel, p.300.

<sup>229</sup> The defense white papers provide ample assurances of China’s peaceful intentions and limited information on PLA military capabilities.

Lanteigne, p.110.

<sup>230</sup> Rodolfo C. Severino, “The Philippines’ National Territory”, **Southeast Asian Affairs**, 2012, p. 257.

<sup>231</sup> Severino, p.258.

<sup>232</sup> Severino, p.258.

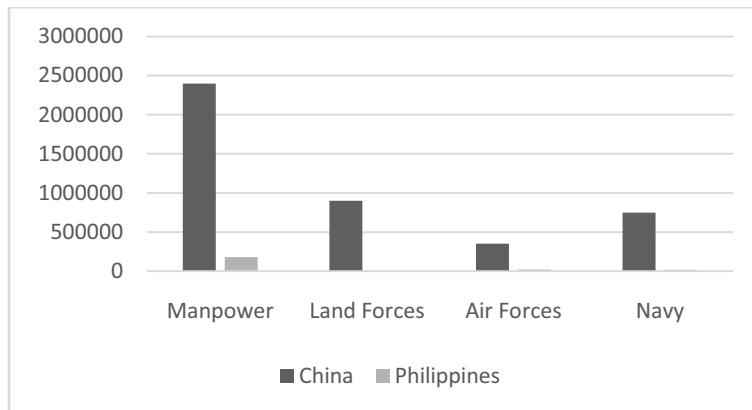
<sup>233</sup> Vibhanshu Shekhar, “ASEAN’s Response to the Rise of China: Deploying a Hedging Strategy”, **SAGE Journals**, Vol.48, No.3, 2012, p.253.

<sup>234</sup> Taiwanese president Lee Teng-hui who were certain to be reelected in the presidential elections, visited the United States in 1995. In order to deter Taiwan from pursuing independence from China and deter the US from promoting Taiwan for the same issue, China conducted a series of military exercises and missile tests in the vicinity of the Taiwan Strait between July 1995 and March 1996. PLA naval vessels and aircraft conducted ten days of live-fire tests off the coast of Fujian. Further military exercises were conducted in mid-November to the south of the Strait, including joint operations involving air, land, and naval arms of the PLA.

Andrew Scobell, “Show of Force: The PLA and the 1995–1996 Taiwan Strait Crisis”, **MIT Press Journals**, 2009, p.5.

<sup>235</sup> Abuza, p.12.

**Figure 4:** Military Power of China and Philippines, 2017



Source: [http://armedforces.eu/compare/country\\_China\\_vs\\_Philippines](http://armedforces.eu/compare/country_China_vs_Philippines), 06.10.18.

Vietnam shares concerns with the Philippines concerning Chinese actions as a threat to its sovereignty. During the Cold War era, China-Vietnam's bilateral relations were hardly smooth. Relations deteriorated due to the Soviet-China rivalry during Vietnamese war against the US. However, in the 1990s, with the help of China's good neighborhood policy, two countries normalized their relations and they also solved their territorial problems.<sup>236</sup> They finalized many peaceful settlements on both land border and maritime issues until the 2000s. For instance, they signed the Treaty of Land Border in 1999 and the Agreement on the Delimitation of Seas, Exclusive Economic Zones and Continental Shelves in the Gulf of Tonkin in 2000.<sup>237</sup> Therefore, after the end of the Cold War, Vietnam's threat perception of China was degraded. Later, in the post-Cold War era, China and Vietnam started to have diplomatic divergence on South China Sea. China's changing approach to the South China Sea has changed the state of affairs since it challenged Vietnam's interests and security from the status quo.<sup>238</sup>

Geographical proximity and the unequal distribution of power between China and Vietnam has played a significant role in their relations.<sup>239</sup> Historically, Vietnam resisted China since they were two feudal empires, because China tried to invade

<sup>236</sup> Cheng, p. 382.

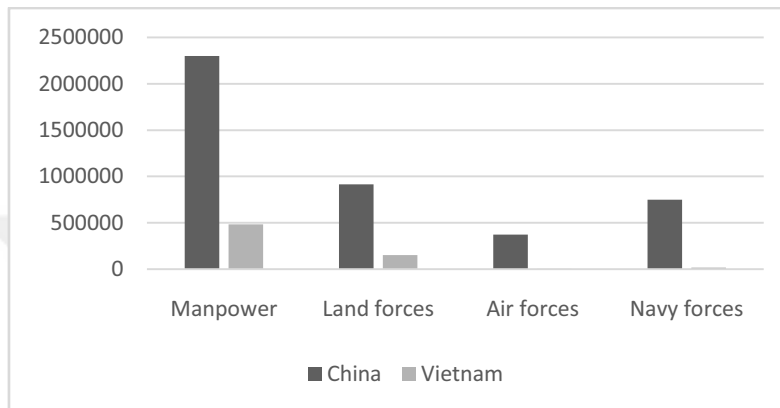
<sup>237</sup> Cheng, p.385.

<sup>238</sup> Thuy and Ngo, p.103.

<sup>239</sup> Le Hong Hiep, "Vietnam's Hedging Strategy against China since Normalization", *Contemporary Southeast Asia*, Vol. 35, No.3, 2013, p.333.

Vietnam many times before.<sup>240</sup> As Vietnam had to defend its homeland many times against China, they hold a siege mentality towards China.<sup>241</sup> Therefore, China's aggressive behaviors in the South China Sea appear to have re-awakened Vietnam's inner concerns about China's aggressive actions.<sup>242</sup>

**Figure 5:** Military Power of China and Vietnam, 2017



Source: [http://armedforces.eu/compare/country/Vietnam vs China](http://armedforces.eu/compare/country/Vietnam%20vs%20China), 06.10.18.

As a result, despite China's assurances with its "New Security Concept" and other initiatives, the Philippines and Vietnam have remained suspicious of China's dominance due to concerns about independence, especially in the context of China's aggressive behaviors in the South China Sea.<sup>243</sup> Their concerns peaked in the 2000s again because China's presence increased in the South China Sea through military modernization, island-building activities and oil exploration activities. Before explaining Chinese actions in detail, the next section will address the reasons for Chinese belligerence.

### 3.1.2. Chinese Approach to the South China Sea

<sup>240</sup> China dominated Vietnam for over 1,000 years (111 B.C. to A.D. 938). After A.D. 938, China invaded Vietnam periodically. Most recently in 1979.

Hiep, p.333.

<sup>241</sup> Udai Bhanu Singh, "Vietnam's Security Perspectives", *Strategic Analysis*, Vol.23, No.9, 2008, p.1481.

<sup>242</sup> Thuy and Ngo, pp.96-97.

<sup>243</sup> Singh, p.1488.

China's aggressiveness in the South China Sea must be addressed by first mentioning the core interests of China, as spelled out by Dai Bingguo, a former State Councilor.<sup>244</sup> These interests include protecting the state system and leadership of the CCP; sustainable development of economy and society; and territorial integrity and sovereignty.<sup>245</sup> First, for China, the sovereignty issue of the South China Sea is an internal matter directly concerning national identity. Therefore, there was an effect of nationalism in the revival of the South China Sea issue. The time from the Opium War until China's "liberation" from the Japanese occupation is known as the "Century of Humiliation" in China.<sup>246</sup> The country considers that if it has the control of the all South China Sea, this might compensate unjust situation and humiliation created by the Western colonizers in the past.<sup>247</sup>

Second, as Neoliberal scholars state, one of the core interests of China is providing economic development. Therefore, having the right to use the resources of the South China Sea's adjunct waters is important for China. The South China Sea is rich in oil and natural gas resources. For this reason, from an economic perspective, China has a need for energy resources, raw materials and natural resources due to the maintenance of its production process and economic development, so that it has become one of the largest importers and exporters in the world.<sup>248</sup>

For the safety of the ships and vessels carrying containers, they must with no exceptions pass through the East China Sea and the South China Sea.<sup>249</sup> Therefore, China has to maintain control of the area; otherwise, they will suffer from a "strategic vulnerability".<sup>250</sup> Furthermore, China also needs to guarantee exploration

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<sup>244</sup> Richard Q. Turcsanyi, "Contradiction of Strategic Goals as a Major Constrain of Chinese Power in the South China Sea", **Power Politics in Asia's Contested Waters**, (Ed. Enrico Fels and Truong-Minh Vu), Springer, Switzerland, 2016, p.180.

<sup>245</sup> Turcsanyi, p.181.

<sup>246</sup> Kheng Swe Lim, "China's Nationalist Narrative of the South China Sea: A Preliminary Analysis", **Power Politics in Asia's Contested Waters**, (Ed. Enrico Fels and Truong-Minh Vu), Springer, Switzerland, 2016, p.163.

<sup>247</sup> Samuel S. Kim, "The Evolving Asian System", **International Relations of Asia**, (Ed. David Shambaugh and Michael Yahuda), Rowman and Littlefield Publishers, the United States of America, 2008, pp. 37-39.

<sup>248</sup> To-far Wang, "China's Economic Development and its Challenges", **Rise of China Beijing Strategies and Implications for the Asia-Pacific**, (Ed. Hsin-Huang Michael Hsiao and Cheng-yi Lin), Routledge, London, 2009, pp.123-124.

<sup>249</sup> Foot, pp.135-136.

<sup>250</sup> Caceres, p.5.

and drilling activities in the Sea to benefit from these resources.<sup>251</sup> These activities can be considered as a means to strengthen its sovereignty over the region. However, this has caused many tensions between the claimants because each seeks to obtain these resources.

China's long-term interests in the South China Sea are more related to security than economic considerations, however. With a natural defense consideration, China seeks to maintain and increase its control over buffer territories near to the Chinese mainland.<sup>252</sup> The territories on the west side of the country, including Mongolia, Manchuria, Tibet and Xinjiang, are critical for China. These territories provide natural protection to the country with deserts and mountains against India from the west, Southeast Asian countries from the south-east, and Russia from the north.<sup>253</sup> However, the western part of the country is more secure when compared to the east and the south, as these parts of the country are open to the East China Sea and the South China Sea.<sup>254</sup> The clashes of interests of many countries and their struggles to gain control over these Seas resulted in increasing national security concerns of China. The country perceives an "encirclement" of the great powers and smaller neighboring countries.<sup>255</sup> Therefore, the Sea plays a vital role in China's territorial integrity and security.

The aforementioned reasons have paved the way for China to use low-intensity coercion to maintain its presence in and control of disputed areas in the sea. Also, the country has made official statements that China's military activities are reactions to threats and incitements of external actors.<sup>256</sup> Therefore, in order to have the capability to control the disputed area, the country made progress in developing its maritime capabilities. China has developed its navy forces with high-level strategies, plans and policies to transform them into more technologically advanced and flexible ones for fighting and winning.<sup>257</sup>

### **3.1.2.1. China's Military Modernization and Military Expenditure Trends**

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<sup>251</sup> Wang, p.126.

<sup>252</sup> Caceres, p.6.

<sup>253</sup> Kim, p.37.

<sup>254</sup> Kim, p.39.

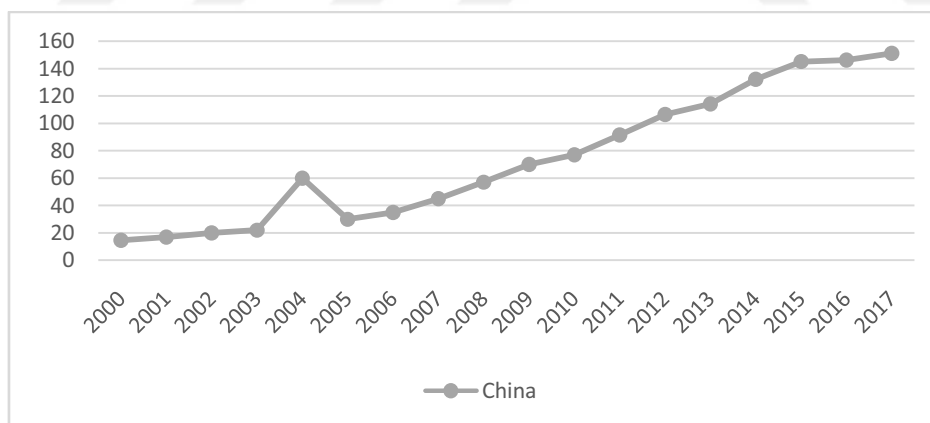
<sup>255</sup> Lim, p.164.

<sup>256</sup> United States of America Department of Defense, **Annual Report to Congress: Military and Security Developments Involving the People's Republic of China 2016**, 2016, p.13.

<sup>257</sup> Annual Report to Congress, p.1.

China's military, the Peoples' of Liberation Army (PLA), has historically been a large land force with limited capacity to sustain power outside of the Chinese borders.<sup>258</sup> In the last decade, China's military power has increased significantly and reached a level that has heightened concerns of other Asian countries. With China's becoming an economic power, the country's potential to cover huge military expenditure increased. Therefore, Its military modernization initiatives have been supported by double-digit real budget increases every year since 1997.<sup>259</sup> Between the years 2000-2003 China's defense budget increased at an average annual rate of 16 percent and this number was 18 percent for the weapons procurement.<sup>260</sup> Between 2006 and 2015 the military budget grew at an average of 9.8 percent.<sup>261</sup> China's defense budget according to official figures was 45 billion \$ in 2007, however according to the US Defense Intelligence Agency (DIA) estimations that it was 85 billion \$.<sup>262</sup> In 2015 this number reached 145 billion \$ and China kept its position as the second-biggest military spender country in the world.<sup>263</sup>

**Figure 6:** China's Defense Budget 2000-2017 (US\$ billion)



Source: GlobalSecurity.org, <https://www.globalsecurity.org/military/world/china/budget.htm>, (11.03.2018).

<sup>258</sup> Phillip C. Saunder, p.135.

<sup>259</sup> Saunder, p.136.

<sup>260</sup> Ikegami, p.22.

<sup>261</sup> Annual Report to Congress, p.78.

<sup>262</sup> Ikegami, p.22.

<sup>263</sup> Annual Report to Congress p.77.



Consequently, the PLAN became able to launch a comprehensive modernization program which includes development of new weapon systems, modernizing naval capabilities systemic reforms to improve the quality of Chinese military personnel and development of new war-fighting doctrines.<sup>264</sup> The development of new weapons systems includes a variety of platforms and weapons acquisition programs to achieve China's strategic objectives.<sup>265</sup> China also has begun to modernize naval capabilities in patrols and training exercises to reinforce China's ability to defend its claims and deter others from challenging China.<sup>266</sup>

The country also has changed its naval strategies. With the change, “offshore defense” doctrine has taken the place of the “near-coast defense” doctrine, which means the expansion of PLAN’s actions.<sup>267</sup> The PLAN, alongside naval assistance for land-based defense and defending China’s coastal military assets and bases, means that their defense activities have gone beyond the 200 nautical miles from China’s EEZ as defined by the UNCLOS.<sup>268</sup>

To sum up, the PLAN currently possesses the largest number of vessels in Asia, it has about 77 major surface combatants, including about 60 main submarines, 55 medium and large marine vessels, and a small warrior on about 85 missile crafts.<sup>269</sup> Traditional single-purpose vessels have been upgraded and replaced with the multi-mission, advanced anti-ship, anti-air and anti-submarine weapons.<sup>270</sup>

Chinese military advancement and its initiatives such as land reclamation projects or creating airstrips on the surfaces of the occupied reefs and aggressive moves in the South China Sea were not welcomed by Vietnam and the Philippines. Although China has assured its neighbors that it has peaceful intentions, it cannot

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<sup>264</sup> Annual Report to Congress, p.8.

<sup>265</sup> This program consists of programs for anti-ship ballistic missiles, anti-ship cruise missiles, land-based cruise missiles, air to land missiles, mines, manned aircraft, unmanned aircraft, submarines, aircraft warships, destroyers, frigates, renewal vessels, hospital ships etc.<sup>265</sup>

Rex Li, “China’s Sea Power Aspirations and Strategic Behaviour in the South China Sea from the Theoretical Perspective of Identity Construction”, **Power Politics in Asia’s Contested Waters**, (Ed. Enrico Fels and Truong-Minh Vu), Springer, Switzerland, 2016, p. 126.

<sup>266</sup> Fels and Vu, pp.127.

<sup>267</sup> Li, p. 125.

<sup>268</sup> Li, p.126.

<sup>269</sup> Li, p. 127.

<sup>270</sup> Li, p. 127.

prevent the concerns of these countries that China might limit the freedom of navigation in the South China Sea by taking the control of the waters.<sup>271</sup>

### 3.1.2.2. China's Reclamation and Construction in the South China Sea

In addition to expanding its defense budget and military modernization, China has begun land reclamation and facility constructions on features in the South China Sea. These land reclamations are near to the Spratly and Paracel Islands. The country added over 3,200 acres of land to the features it occupies and scraped channels to provide access to these outposts.<sup>272</sup> Also, it created artificial harbors and berthing areas for larger ships. At the final stage of feature development, China made infrastructure construction to add communication, surveillance systems and logistical support plants.<sup>273</sup>

The country has claimed that these initiatives are intended to improve living and working conditions, improve the search and rescue capabilities in the South China Sea, and support their radar and intelligence system.<sup>274</sup> However, the features of this artificial lands are broadly designed, such that China can utilize these facilities for anything from military to fishing purposes.<sup>275</sup>

Chinese fishing squads may extend their duration and their fishing activities with facileness of newly constructed artificial islands. China's missile sites, fighter jets, airstrips, harbors and surveillance stations based on the artificial islands may strengthen country's coercive capabilities and allowing Beijing to deploy its military quickly.<sup>276</sup> With the increase in the number of China's military bases in strategic locations in the South China Sea, the country has created a web of its military bases

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<sup>271</sup> Jay Batongbacal, "Reclamation in the South China Sea: Legal Loopholes, Practical Impacts", **Asian Maritime Security Initiative**, 18.02.2015, <https://amti.csis.org/reclamation-in-the-south-china-sea-legal-loopholes-practical-impacts/>, (18.03.18).

<sup>272</sup> Annual Report to Congress, p.13.

<sup>273</sup> Annual Report to Congress, p.13.

<sup>274</sup> Annual Report to Congress, p.14.

<sup>275</sup> Tran Truong Thuy, "Land Reclamation: A South China Sea Game Changer", **Asia Maritime Transparency Initiative**, 12.10.2014, <https://amti.csis.org/land-reclamation-a-south-china-sea-game-changer/>, (18.02.18).

<sup>276</sup> Robert Klipper, "Why China Might Seek to Occupy Scarborough Shoal", **The Diplomat**, <https://thediplomat.com/2016/03/why-china-might-seek-to-occupy-scarborough-shoal/>, 29.04.2016, (16.03.18).

which connect bases in the north to the east and the west.<sup>277</sup> Ultimately, this serves China's efforts to preserve its presence in the South China Sea, provide support to its navy and improve its defense infrastructure in the South China Sea.<sup>278</sup>

**Figure 7:** Satellite Images of Subi Reef in the Spratly Islands Archipelago



Source: Asia Maritime Transparency Initiative, <https://amti.csis.org/comparing-aerial-satellite-images-chinas-spratly-outposts/>, (16.02.2018).

**Figure 8:** Satellite Images of Fiery Cross Reef in the Spratly Islands Archipelago



Source: Asia Maritime Transparency Initiative, <https://amti.csis.org/comparing-aerial-satellite-images-chinas-spratly-outposts/>, (16.02.2018).

<sup>277</sup> Tran Truong Thuy, "Land Reclamation: A South China Sea Game Changer", **Asia Maritime Transparency Initiative**, 12.10.2014, <https://amti.csis.org/land-reclamation-a-south-china-sea-game-changer/>, (18.02.18).

<sup>278</sup> Annual Report to Congress, p.7.

Previous part covered the basis of China's being threat to sovereignty of the Philippines and Vietnam with all details including historical, legal and strategic ones. In the next section, incidents which led the parties to engage in small scale conflicts will be explained in a comprehensive way each for the Philippines and Vietnam. Subsequently, defense responses against Chinese aggressive actions will be analyzed.

### **3.2. Security Relations of China and the Southeast Asian Countries**

#### **3.2.1. The Philippines-China Security Relations in the South China Sea (2000-2017)**

The Philippines is skeptical about China's recent initiatives in the South China Sea, which threaten may threaten their sovereignty. Before the South China Sea dispute became an important topic in the Philippines agenda, the country's perceptions of China were not different than the existing approach. During the late 1990s, China threatened the Philippines' sovereignty many times in the South China Sea. Firstly, China occupied the Mischief Reef in the Spratly Islands in 1994 and Chinese troops detained the crew of a fishing vessel for days on the area in 1995.<sup>279</sup> In the same year, Philippine reconnaissance aircraft observed Chinese buildings on the reef, consisting of platforms with bunkers and equipped with satellite communication equipment.<sup>280</sup> Later on, a small scaled skirmish happened between the Chinese and the Philippines warships in 1996.

Second, since the last incident occurred in 1995, the Philippines realized that the Chinese structures on the Mischief Reef had been upgraded.<sup>281</sup> Tensions between parties never decreased, as the country found out new Chinese structures near the Reef in 1997.<sup>282</sup> Also, two Chinese vessels belonging to the Chinese State Oceanic Administration, intercepted the Philippine Navy near to the Scarborough Shoal. Later on, in 1998, although the Philippines planted its flag on the reef, the country noticed the Chinese vessels taking off construction materials at the reef and many Chinese workers constructing a new structure.<sup>283</sup> The Philippines condemn the Chinese

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<sup>279</sup> Storey, p.97.

<sup>280</sup> Storey, p.97.

<sup>281</sup> Zhao, p.17.

<sup>282</sup> Zhao, p.18.

<sup>283</sup> Storey, p.99.

actions on the area and its navy arrested twenty Chinese fishermen with the accusation of illegal fishing.<sup>284</sup>

The Philippines' existing security concerns and negative perceptions of China had not changed in the 2000s. The Philippines is one of the poorest countries in the Southeast Asia and besides its economic weakness, it also suffers from political and military inadequacy. Political representatives were aware of the capacity of the country thus their foreign policy was simply based on being friends with the other countries and avoiding any conflicts with them.<sup>285</sup> Nevertheless, China's presence has increased in the disputed area, with actions such as island building activities, territorial claims and oil exploration activities.

China's aggressive island building activities in in the South China Sea, including the Spratly Islands and Scarborough Shoal, have alarmed the Philippines because they are considered as a threat to its national sovereignty. As the Philippines have already faced with the same situation in 1990s they are already sceptic about these actions. Chinese actions especially its construction of a large artificial island on an atoll known as Mischief Reef was not acceptable for the Philippines.<sup>286</sup> With fully equipped new artificial islands, China has superiority and leverage in the area. Also, China utilized facilities to a large extent from military to fishing purposes.<sup>287</sup> Moreover, the Philippines considers area as its territorial water so that has sovereignty over.

Second, in territorial disputes, Scarborough Shoal is one of the conflicting areas between China and the Philippines, which is the largest atoll in the South China Sea and is rich with fish, sea turtles and other types of living marine resources. In accordance with the "regime of islands" principle under the UN Convention on the Law of the Sea, the Philippines presented the geographical coordinates of its

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<sup>284</sup> Mohan Malik, "Historical Fiction: China's South China Sea Claims", **World Affairs**, Vol. 176, No. 1, 2013, p. 87.

<sup>285</sup> Malik, p.89.

<sup>286</sup> Jane Perlez, "Tribunal Rejects Beijing's Claims in South China Sea", **the New York Times**, 12.07.15, <https://www.nytimes.com/2016/07/13/world/asia/south-china-sea-hague-ruling-philippines.html?rref=collection%2Ftimestopic%2FSouth%20China%20Sea>, (17.02.18).

<sup>287</sup> Tran Truong Thuy, "Land Reclamation: A South China Sea Game Changer", **Asia Maritime Transparency Initiative**, <https://amti.csis.org/land-reclamation-a-south-china-sea-game-changer/>, (18.02.18).

archipelagic baselines to the UN in 2009.<sup>288</sup> According to the coordinates, the Scarborough Shoal takes place within the Philippines EEZ.<sup>289</sup>

**Figure 9:** The South China Sea



Source: GlobalSecurity.org, <https://www.globalsecurity.org/military/world/war/south-china-sea-background.htm>, (20.05.2018).

In the Shoal, a serious standoff occurred in 2012 when a Filipino warship confronted eight Chinese fishing vessels that were harvesting marine resources. China blocked the Philippine ship from taking action and sent a large number of vessels to the area to prevent access to the Shoal's lagoon. China has operations in Scarborough Shoal and Second Thomas Shoal. China Coast Guard (CCG) ships have maintained a presence in the area since 2012.<sup>290</sup> Chinese official stated that the patrols presence was normal and just as the country has indisputable sovereignty over many features in the South China Sea. Both China and the Philippines have

<sup>288</sup> The 1982 United Nations Convention on the Law of the Sea (UNCLOS), which entered into force in 1994, is the most basic legal document in restricting and regulating the sovereignty of states in maritime areas. It should also be noted that China, the Philippines and Vietnam are parties of the UNCLOS. According the UNCLOS, the area beyond the 12 nautical miles stretching from the shoreline of a country to the adjacent sea, including the airspace over these waters, sea bed and the land is defined as the territorial waters of that country under its sovereignty.

Ortuoste, p.241.

<sup>289</sup> Ortuoste, p.241.

<sup>290</sup> Annual Report to Congress, p.7.

claims over them thus while China keeps its patrols, the Philippines do keep military personnel on a tank landing ship on the area since 1999.<sup>291</sup>

Third, the oil exploration activities of the Philippines in the South China Sea have been restricted by China. Being able to get benefits from rich oil resources and conduct oil exploration activities in the Sea became important for the Philippines due to an increase in its energy consumption. This situation brought along huge energy demand. According to the International Energy Agency (IEA), the country's energy demand grew at an average rate of 2.8% per year from 2007 to 2030. In 2010, oil composed 35 percent of the Philippines' primary energy consumption.<sup>292</sup> While the country had 282 thousand bpd (barrels per day) oil consumption in 2010, it was producing only 23 thousand bpd and this was from the South China Sea.<sup>293</sup> The country is dependent on oil-rich Arab countries and Indonesia to meet this energy deficit.<sup>294</sup> As the Philippines has complicated relations with those countries, the country has sought to increase its domestic oil production and to prevent problems which might occur due to unstable energy supply.<sup>295</sup>

In 2005, the Philippines, Vietnam and China signed an Agreement for a Joint Marine Seismic Undertaking (JMSU) between their national oil companies for researching petroleum potential in the South China Sea.<sup>296</sup> With this agreement, the parties decided to find opportunities for joint development of disputed areas of the South China Sea without threatening the positions of each other on sovereignty issues. However, the parties did not share the details of this agreement. Therefore, after it emerged that the Philippines' continental shelf was included in JMSU which is an undisputed area of the country, the agreement was terminated.<sup>297</sup>

With the collapse of JMSU, the Philippines began searching for natural resources in the South China Sea.<sup>298</sup> China did not welcome the Philippines' oil exploration activities in Reed Bank, as Beijing has allegations over the area. Therefore, China increased its surveillance over the area and began disputes with

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<sup>291</sup> Annual Report to Congress, p.7.

<sup>292</sup> Brantly Womack, "The Spratly Islands: From Dangerous Ground to Apple of Discord", **Contemporary Southeast Asia**, Vol. 33, No. 3, 2011, p.12.

<sup>293</sup> Womack, p.13.

<sup>294</sup> Womack, p.14.

<sup>295</sup> Zhao, p.10

<sup>296</sup> Ndi, p.270.

<sup>297</sup> Heydarian, p.340.

<sup>298</sup> Heydarian, p.341.



Philippines' survey ships.<sup>299</sup> These ships had previously been operating freely in the same area. However, Chinese patrol boats intimidated government-contracted oil exploration vessels in an area which the Philippines considers to be its EEZ.<sup>300</sup> Therefore, in response, The Philippine Air Force deployed two planes, but the vessels had already left the area.<sup>301</sup>

### 3.2.1.1. Defense Response of the Philippines

In this framework, maintaining its security over the area has become crucial for the Philippines from a realist point of view. In general, the priority of states is to maintain their sovereignty and protect their national interests against any external threat, although they may have the developed economic relations with the aggressor state. According to realists, there are several means for the weaker states to cope with major powers. The first is internal balancing which necessitates the engagement of a weaker state with a stronger power.<sup>302</sup> In this way, a weaker state develops its military capacity, builds up arms and increases its deterrence capacity. Second, external balancing behavior which can be considered as the core of the traditional balance of power theory.<sup>303</sup> It requires making alliances with other powers against the preponderant threat.<sup>304</sup> The aggressor state's superior offensive capability and its aggressive intentions led the creation of defensive coalitions by the threatened states.<sup>305</sup> Therefore, states participate in alliances to preserve themselves from the stronger states with greater resources.<sup>306</sup> Third, a weaker state deals with a stronger power through bandwagoning, which means alignment with the source of a threat.<sup>307</sup> Fourth, weaker states might choose buck-passing, in which they keep a neutral stance. The last method is a hedging strategy, which consist of elements from balancing, bandwagoning and neutrality. It aims to avoid the situation in which states

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<sup>299</sup> Hendrik W. Ohnesorge, "A Sea of Troubles: International Law and the Spitsbergen Plus Approach to Conflict Management in the South China Sea", **Power Politics in Asia's Contested Waters**, (Ed. Enrico Fels and Truong-Minh Vu), Springer, Switzerland, 2016, p. 27.

<sup>300</sup> Ohnesorge, p.28.

<sup>301</sup> Ohnesorge, p.29.

<sup>302</sup> Stephan M. Walt, "Alliances: Balancing and Bandwagoning", **International Politics**, (Ed. Robert J. Art and Robert Jervis), Addison-Wesley Educational Publishers Inc., New York, 2000, p.110-111.

<sup>303</sup> Walt, p.111.

<sup>304</sup> Walt, p.112.

<sup>305</sup> Walt, p.116.

<sup>306</sup> Walt, p.116.

<sup>307</sup> Walt, p.117.



cannot decide on alternatives and minimize the risks of security cooperation with a great power.

In the case of the Philippines, despite the country having strong claims over Spratly Islands, it has no capacity to defend them against China. In 2011, when Chinese and Filipino vessels confronted each other near Reed Bank, only two slow turboprop aircraft of the Philippines arrived while Chinese patrol ships were already departing.<sup>308</sup> With limited resources on hand, the Philippines could not compete over the South China Sea.

Therefore, as a small power, the Philippines chose internal and external balancing behavior towards China. In external balancing, the strongest policy the Philippines was adopted in response to Chinese aggression in the SCS was the move to strengthen its relationship with the United States. With this way country aimed to strengthen its deterrence capability and increase its bargaining opportunities to be able to convince China to negotiate over the disputed areas.<sup>309</sup> For internal balancing purposes, the Philippines increased its military spending to modernize its military. Therefore, it has improved its military capabilities and engaged in military cooperation and exercises with external powers due to their security concerns.

With the concerns of Chinese aggression in the South China Sea, the Philippines have significantly enhanced military and political ties with the US, who have played a significant role in external security of the country since the 1990s. They participated in 15 joint military exercises in 2002.<sup>310</sup> Moreover, both parties' navies conducted maritime exercises in the Spratly Islands to show their maritime power in the disputed areas of the South China Sea.<sup>311</sup> After the Scarborough Shoal incident, the country also revived the 1951 Philippines-U.S. Mutual Defense Treaty.<sup>312</sup> In 2014 and 2015, the Philippines and the US together have operated joined exercises in the South China Sea, and US personnel provided training to the Philippines.

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<sup>308</sup> Felix K. Chang, "Transforming the Philippines Defense Architecture: How to Create a Credible and Sustainable Maritime Deterrent", **Foreign Policy Research Institute**, 2012, p.5-7.

<sup>309</sup> Leszek Buszynski, "Realism, Institutionalism, and Philippine Security", **Asian Survey**, Vol. 42, No. 3 2002, p.500.

<sup>310</sup> Buszynski, p.503.

<sup>311</sup> Chang, p.8.

<sup>312</sup> The Philippines and the U.S. signed in 1951 a mutual defense treaty where both nations agree to support each other if either the Philippines or the United States were to be attacked by an external party.

The Philippines has diversified its alliances in addition to its traditional ally of the US. First, it signed a statement of Intent of the Greater Defense Cooperation Agreement with Japan in 2012. This agreement allowed the Philippines to conduct military exercises together with Japan and also to get defense equipment and technology. Secondly, the Philippines signed a Military Pact with Russia in 2017.<sup>313</sup> Both countries started have defense industry cooperation and conducting military training exercises.<sup>314</sup> Even though currently their relation only includes limited areas, the Philippines took steps to build stronger ties with Russia.

The Philippines have significantly increased funding for military modernization and the Armed Forces of the Philippines (AFP) with the aim of developing its naval military capability.<sup>315</sup> The country implemented a 15-years defense reform program in 2004 for the modernization of its military. Although the military expenditures of the Philippines are limited, the country uses its annual defense budget for modernization, acquisition and personnel. Between 2005 and 2007, defense expenditures were 0.9 % of GDP. This number reached 1.9 % in 2009, or 1.32 billion \$. The military expenditure of the region is 2.75 billion \$; thus, in comparison the Philippines' expenditures make up half of the whole region.<sup>316</sup>

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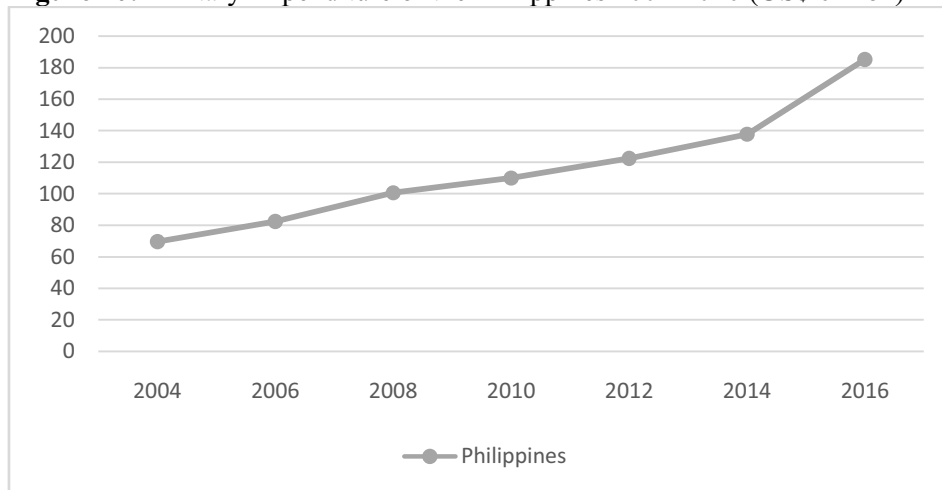
<sup>313</sup> Prashanth Parameswaran, "What's in the New Russia-Philippines Military Pact?", **The Diplomat**, 01.05.2017, <https://thediplomat.com/2017/06/whats-in-the-new-russia-philippines-military-pact/>, (01.05.18).

<sup>314</sup> Genalyn D. Kabiling, "Intensified defense cooperation between PH, Russia", **Manila Bulletin**, 11.12.2017, <https://news.mb.com.ph/2017/11/10/intensified-defense-cooperation-between-ph-russia/>, (01.05.18).

<sup>315</sup> Abuza, p.1.

<sup>316</sup> Abuza, p.4.

**Figure 10: Military Expenditure of the Philippines 2004-2016 (US\$ billion)**



Source: <https://tradingeconomics.com/philippines/military-expenditure>

In addition to their defense cooperation, the US also provided financial assistance and military aid to the Philippines.<sup>317</sup> In 2001, the amount of military education and training funds was 1.9 million US \$, and in 2005 this increased to 126 million US \$. In 2009, the Philippines also received one of the highest amounts of foreign military financing from the US.<sup>318</sup>

The Philippines has purchased offshore patrol vessels, missile boats, helicopters, surface-to-air missile and gun systems. It also obtained three multi-purpose attack craft from Taiwan.<sup>319</sup> The country has also received military hardware from the US. In terms of military cooperation, Russia has also provided military equipment to the Philippines.<sup>320</sup> As a part of their defense cooperation with Japan, the Philippines have accepted Japanese military aid. Tokyo has provided patrol boats to the Philippine Coast Guard (PCG) and other modern vessels.

### 3.2.2. Vietnam-China Security Relations in the South China Sea (2000-2017)

Since 2000, Vietnam and China have made less progress in territorial disputes in the South China Sea, as both parties have claims on the Paracel and Spratly

<sup>317</sup> Abuza, p.3.

<sup>318</sup> Abuza, p.3.

<sup>319</sup> Abuza, p.3.

<sup>320</sup> Prashanth Parameswaran, "Why Japan's New Military Aircraft Gift to the Philippines Matters", *The Diplomat*, 31.10.17, <https://thediplomat.com/2017/10/why-japans-new-military-aircraft-gift-to-the-philippines-matters/>, (01.05.18).

Islands.<sup>321</sup> China has continued to maintain its presence and allegations along with a change in its policy toward the South China Sea. With a change in its policy, China's presence has increased in the disputed areas with actions such as military modernization, island building activities, unilateral fishing ban and oil exploration activities. These actions are considered by Vietnam as threats to its national sovereignty

and are deemed as acceptable.<sup>322</sup>

First, Vietnam is concerned about military modernization of China as its naval capabilities are far below those of China. China's economic superiority has paved the way for the increase in country's defense budget and upgrades in its military capacity. China's 2011 military spending was equal to the 8.2 percent of world military spending. The country's military spending increased by 500 percent since 1195 and 170 percent since 2002.<sup>323</sup> These numbers are menacing to Vietnam.

Furthermore, as earlier mentioned China added over 3,200 acres of land to the features it occupies and also created new outposts.<sup>324</sup> Vietnam was also doing similar things by expanding the features of Sand Cay. However, in comparison Vietnamese land reclamations totaled 1.9 percent of the area built by China. In addition to creating artificial outposts in the South China Sea, China also developed Sansha city in Hainan province, which is an area in which China and Vietnam have overlapping claims. This action caused increasing national sentiments in Vietnam and Vietnamese students protested in front of Chinese Embassy in Hanoi in 2007. As a result, Vietnam has concerns over the negative effects of China's actions on its domestic politics. China's attitudes toward encouraging its people to explore uninhabited island in the East China Sea have further increased these concerns.

With the help of its upgraded navy and fully equipped new artificial islands, China has both superiority and leverage. The country began to disturb Vietnam's people and fishing boats in the disputed area. First, in 2007, China placed boundary markers on the Paracel Islands, while Chinese naval vessels blocked four Vietnamese

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<sup>321</sup> Amer, p.20.

<sup>322</sup> Amer, p.22.

<sup>323</sup> Ortuoeste, p.242.

<sup>324</sup> "China has reclaimed 3,200 acres in the South China Sea, says Pentagon", **The Guardian**, 16.05.2016, <https://www.theguardian.com/world/2016/may/13/pentagon-report-china-reclaimed-3200-acres-south-china-sea>. (05.04.18).

fishing boats in the water near to Paracel Islands.<sup>325</sup> Chinese vessels also began to disturb Vietnamese fishing boats and even sank one, causing the death of a Vietnamese fisherman.<sup>326</sup>

Second, Chinese actions have become more assertive, limiting Vietnam's presence in the area. For instance, China announced an annual fishing ban in the South China Sea during spawning season in 2011. The ban was unilateral and became an obstacle for Vietnam's fishing activities.<sup>327</sup> During the period that there was a fishing ban, there were more Chinese fishing boats within the Vietnam's coastal area. A Chinese naval vessel followed one Vietnamese fishing boat near to the islands and forced the boat to leave the area and threatened the crew with armed force.<sup>328</sup> Therefore, it is possible to claim that China was violating Vietnam's sovereignty over the Paracel Islands. Therefore, the fishing ban and China's aggressive behavior worried Vietnam due to the possibility of more provocative actions of China in future. Also, China's unilateral actions deepened suspicions toward the country and resulted in Vietnamese consolidation of its defense capacity and a search for alliances.

Third, after the cancelation of JMSU, Vietnam started to take unilateral actions for resource exploration since the rich oil and gas resources in the South China Sea could provide supply for its growing economy. China claimed that Vietnamese activities in the area were illegal. This situation caused many incidents which carried huge risk of military confrontation among the parties. For example, a Chinese surveillance ship approached a Vietnamese seismic survey ship in 2011.<sup>329</sup> Again in the same year, in the South China Sea, Chinese fishing boats collided with a Vietnamese oil and gas exploration vessel. In 2014, China began operating Hai Yang Shi You (HYSY) 981, a mega oil drilling platform, in disputed areas covering

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<sup>325</sup> Ndi, p.270.

<sup>326</sup> Carlyle A. Thayer, "Vietnam and Rising China: The Structural Dynamics of Mature Asymmetry", **Southeast Asian Affairs**, 2010, p.402.

<sup>327</sup> "China has reclaimed 3,200 acres in the South China Sea, says Pentagon", **The Guardian**, 16.05.2016, <https://www.theguardian.com/world/2016/may/13/pentagon-report-china-reclaimed-3200-acres-south-china-sea>. (05.04.18).

<sup>328</sup> "China has reclaimed 3,200 acres in the South China Sea, says Pentagon", **The Guardian**, 16.05.2016, <https://www.theguardian.com/world/2016/may/13/pentagon-report-china-reclaimed-3200-acres-south-china-sea>. (05.04.18).

<sup>329</sup> Womack, p.231.

Vietnam's EEZ.<sup>330</sup> Although the Chinese operation was commercial exploration, according to Vietnam it was violating the country's security. As a result of China's operations, a clash occurred between Chinese and Vietnamese ships.<sup>331</sup>

Moreover, China is continuously trying to set back Vietnam's initiatives. Vietnam has a "Maritime Strategy Towards the Year 2020" which aims to integrate economic development of the coastal areas with the marine resources of the South China Sea.<sup>332</sup> With the contribution of marine economy to 55 percent of Vietnam's GDP, its maritime development was completed in 2007.<sup>333</sup>

Nevertheless, China has been putting pressure on foreign firms which are likely to become involved in Vietnam's maritime development and take part in exploitation of resources in the South China Sea. China considers these activities of Vietnam as a threat to its territorial sovereignty. Therefore, the Chinese Foreign Ministry stated that the project of British Petroleum (BP) to foster energy resources in the Nam Con Son basin is illegal and invalid.<sup>334</sup> Furthermore, China has warned Exxon Mobile officials not to make any deal with Vietnam to explore energy resources in the South China Sea.<sup>335</sup>

#### **3.2.2.1. Defense Response of Vietnam**

In 2009 a Defense White Paper issued by the Vietnamese Ministry of Defense made it understood that the two main aims of the defense policy of Vietnam are to preserve national security and maintain regional order.<sup>336</sup> In order to protect its sovereignty in the South China Sea Vietnam have sought to implement different strategies. Similar to the Philippines, China and Vietnam are asymmetrical powers in terms of military and maritime power. Therefore, the county has invested in improving its deterrent capacity for both internal and external balancing for its claims in the South China Sea.<sup>337</sup> For external balancing purposes, Vietnam has

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<sup>330</sup> Ngan, p.12.

<sup>331</sup> Ngan, p.13.

<sup>332</sup> Thayer, p.401.

<sup>333</sup> Thayer, p.401.

<sup>334</sup> Thayer, p.402.

<sup>335</sup> Thayer, p.402.

<sup>336</sup> Vietnam National Defense, **Ministry of National Defense**, Socialist Republic of Vietnam, Hanoi, 2009, pp.103-105.

<sup>337</sup> Thuy and Ngo, p.14.

begun to expand security cooperation and alliances, seeking to boost ties with the US as part of its foreign policy to engage a range of major powers to improve its defense capabilities.<sup>338</sup> Despite its historical animosity with the US, the country normalized its security relations with the US in 1995 paving the way for strengthening its stand against increasing Chinese aggressiveness. Despite Vietnam's foreign and security policy doctrine of "three no's"<sup>339</sup>, the more the country's convergence increased with China, the closer it became to the US.<sup>340</sup>

To diversify its alliances, Vietnam has attempted to gain closer military relations with countries such as Russia, Japan and India. First, the country strengthened its historical defense relations with Russia. In 2012, both parties raised their strategic partnership to a comprehensive strategic partnership and they agreed on cooperating in many areas including military equipment, military trainings and technology.<sup>341</sup> Secondly, Vietnam has had enhanced bilateral defense cooperation with Japan since 2006.<sup>342</sup> Both countries have signed and adopted many agreements on security and defense cooperation up to the today.<sup>343</sup> Lastly, in 2007, India and Vietnam signed a thirty-three point Joint Declaration on Strategic Partnership on

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<sup>338</sup> Zha, p. 36.

<sup>339</sup> These three no's are: No military alliances, no foreign military bases in Vietnam, and no reliance on outside help in combat.

Li, p.143.

<sup>340</sup> In 2005, Vietnam and the US established an International Military Education and Training and the US support the country in training its military. In 2011, as a result of the Political, Security, and Defense Dialogue of 2008 and Defense Policy Dialogue of 2010, Vietnam and the US signed a memorandum of understanding in the five different areas which also includes defense cooperation and maritime security. Then in 2013, it turned out to be a comprehensive defense partnership. Both party's coast guards started to collaborate and conducting joint exercises and also the US was assisting Vietnam in its maritime security. Another big step in their defense cooperation was in 2014, with the US's lifting of the arms embargo on Vietnam. Following that in 2015, both parties signed a Joint Vision Statement on Defense Relations and all restrictions are removed thus Vietnam could provide weapons for its defense.

Prashanth Parameswaran, "Why Obama's Lifting of the Vietnam Arms Embargo Matters", **The Diplomat**, 24.05.2016, <https://thediplomat.com/2016/05/why-obamas-lifting-of-the-vietnam-arms-embargo-matters/>, (20.05.2018).

<sup>341</sup> "VN, Russia agree to intensify comprehensive strategic ties," **Viet Nam News**, 16.05.2016, <http://vietnamnews.vn/politics-laws/296865/vn-russia-agree-to-intensify-comprehensive-strategic-ties.html#qVSwzLtogmKTUQvf.97>, (20.05.2018).

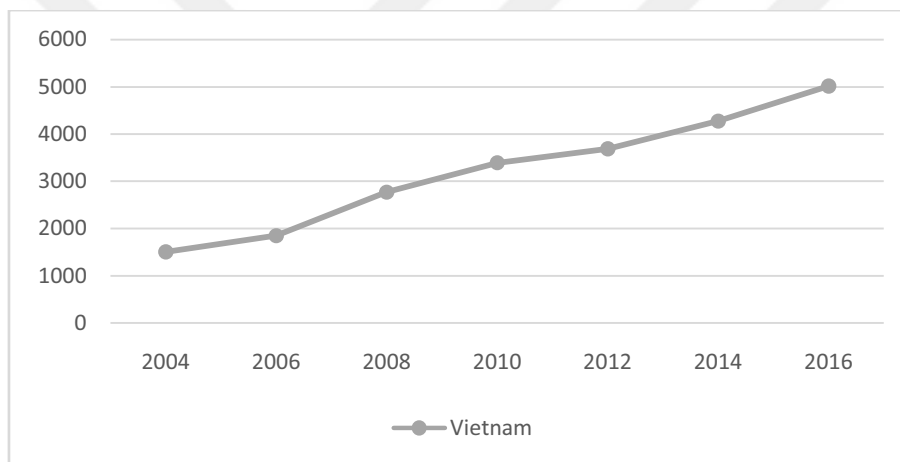
<sup>342</sup> "Vietnam, Japan to boost defense cooperation," **People's Army Newspaper Online**, 23.10. 2016, <http://en.qdnd.vn/military/intl-relations-and-cooperation/vietnam-japan-to-boost-defense-cooperation-and-exchange-482461>, (20.05.2018).

<sup>343</sup> "Vietnam, Japan to boost defense cooperation," **People's Army Newspaper Online**, 23.10. 2016, <http://en.qdnd.vn/military/intl-relations-and-cooperation/vietnam-japan-to-boost-defense-cooperation-and-exchange-482461>, (20.05.2018).

defense and security.<sup>344</sup> This includes cooperation on defense supplies, joint projects, trainings and intelligence exchanges.

Per the framework of the Defense White Papers of 2004 and 2009, in order to implement this and for internal balancing purposes, Vietnam started to modernize its military to upgrade its naval, air and electronic fighting capability.<sup>345</sup> Vietnam expanded its defense budget in order to modernize its military and upgrade its defense capacity. Therefore, the country increased its defense budget; its military spending were 2771.4 billion US \$ in 2008, this number reached 5017.4 billion US \$ in 2016.<sup>346</sup>

**Figure 11:** Military Expenditure of Vietnam 2004-2016 (US\$ billion)



Source: <https://tradingeconomics.com/vietnam/military-expenditure>

The country started to acquire ships, frigates, and submarines for its navy and anti-ship cruise missiles to upgrade its land-based defense. Furthermore, in order to improve capability of coordination of its maritime forces, Vietnam began increasingly training its military. Also, the country developed its own defense industry by co-production and technology transfer activities.

<sup>344</sup> “General Ngo Xuan Lich’s official visit to India wraps up successfully,” **Vietnam Breaking News**, 8.12.2016, <https://www.vietnambreakingnews.com/2016/12/general-ngo-xuan-lichs-official-visit-to-india-wraps-up-successfully/>, (20.05.2018).

<sup>345</sup> Kaplan, p.54.

<sup>346</sup> Vietnam Military Expenditure, **Trading Economics**, <https://tradingeconomics.com/vietnam/military-expenditure>, (20.05.2018).



Even though Vietnam has made a huge effort to spend more for defense, economic considerations limit its capacity building activities. Therefore, Vietnam seek to have military acquisitions also from its military alliances.<sup>347</sup> As a part of its defense cooperation with the US, Vietnam has acquired military hardware mostly in maritime security domain. The US has also provided the country with patrol vessels to enhance its capacity of its patrol units, along with 18\$ million to help Vietnam buy patrol boats.<sup>348</sup> Furthermore, the country has purchased submarines, frigates, anti-submarine warfare and fighter aircraft from Russia.<sup>349</sup> Vietnam upgraded its Petya-class light frigates for anti-submarine and also. The country also received patrol vessels from India.<sup>350</sup> Vietnam has also received secondhand anti-submarine patrol aircraft from Japan.<sup>351</sup>

### 3.3. CHAPTER CONCLUSION

The approaches and actions of Philippines and Vietnam towards China have been shaped by serious security concerns. To start with the Philippines, the country has given a significant attention to China's actions since 1996, when the PLA conducted military exercises and launched several short-range ballistic missiles tests into the waters off Taiwan.<sup>352</sup> This epitomized China's belligerence and lack of hesitation to use force when it comes to its interests.<sup>353</sup> Furthermore, in the 1990s, China threatened the Philippines' sovereignty many times in the South China Sea. Firstly, China occupied the Mischief Reef in the Spratly Islands in 1994 and a small scaled skirmish happened between the Chinese and the Philippines warships in 1996.

<sup>347</sup> Prashanth Parameswaran, "US, Vietnam Deepen Defense Ties", **The Diplomat**, 05.05.2015, <https://thediplomat.com/2015/06/why-vietnam-and-the-us-are-deepening-defense-ties/>, (20.05.2018).

<sup>348</sup> Eleanor Albert, "The Evolution of U.S.–Vietnam Ties", **Council on Foreign Affairs**, 07.04.18, <https://www.cfr.org/backgrounder/evolution-us-vietnam-ties>, (20.05.2018).

<sup>349</sup> "VN, Russia agree to intensify comprehensive strategic ties," **Viet Nam News**, 16.05.2016, <http://vietnamnews.vn/politics-laws/296865/vn-russia-agree-to-intensify-comprehensive-strategic-ties.html#qVSwzLtogmKTUQvf.97>, (20.05.2018).

<sup>350</sup> "General Ngo Xuan Lich's official visit to India wraps up successfully," **Vietnam Breaking News**, 8.12.2016, <https://www.vietnambreakingnews.com/2016/12/general-ngo-xuan-lich-official-visit-to-india-wraps-up-successfully/>, (20.05.2018).

<sup>351</sup> "Vietnam, Japan to boost defense cooperation," **People's Army Newspaper Online**, 23.10. 2016, <http://en.qdnd.vn/military/intl-relations-and-cooperation/vietnam-japan-to-boost-defense-cooperation-and-exchange-482461>, (20.05.2018).

<sup>352</sup> Andrew Scobell, "Show of Force: The PLA and the 1995–1996 Taiwan Strait Crisis", **MIT Press Journals**, 2009, p. 5

<sup>353</sup> Abuza, p.12.

China has tried to invade Vietnam many times .<sup>354</sup> Their recent aggressive behaviors in the South China Sea seem to have re-awakened both the Philippines' and Vietnam's inner concerns.<sup>355</sup> For the Philippines, the Scarborough Shoal standoff in 2012, and for Vietnam small-scale skirmish with Chinese vessels in 2011, exemplify recent incidents. The countries have realized China's tendency to enter into or escalate conflict to support its territorial claims.

This chapter has underlines that the neorealist arguments are better suited to explain China- the Philippines and China-Vietnam relations in the South China Sea case. In all such bilateral relations, states have been unable to solve their security issues despite their developed economic relations when the context is survival. According to Kenneth Waltz, a state's main motivation is to maximize power in an anarchic international system. In the context of China, the country is threatening the weak Southeast Asian countries in the South China and meanwhile upgrading its military power with the support of its economic development. Unequal distribution of power has created uncertainty for the Philippines and Vietnam. They cannot be sure if China will take advantage of its power and conduct revisionist actions, let alone whether they will be attacked by China. Consequently, from a structural realist point of view, they are willing to sacrifice their economic gains from economic exchange to protect their security under all circumstances including military conflicts with China.

Kenneth Waltz also points out that vulnerable states are fearful of relative gains made by other states. As discussed in the second chapter, through economic interactions including trade, FDI and other financial channels, China-the Philippines and China-Vietnam have enhanced their economic ties with each other. In their economic transactions, there have been undeniable absolute gains on all sides. However, there is a significant relative gain of China coming from its economic interactions with the Philippines and Vietnam which enable the country to invest more on its military. Thus, relative gains consideration combines with China' military modernization to make the country a potential security threat, either directly from territorial disputes or indirectly through challenging the current status quo.

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<sup>354</sup> Hiep, p.333.

<sup>355</sup> Thuy and Ngo, pp.96-97.

In the South China Sea dispute, for Vietnam and the Philippines there are a few scenarios to respond China's aggressiveness. These include doing nothing, balancing, defending and having the control of the area and islands. The first option, doing nothing, is unlikely to happen in the international system where states ultimate goal is to survive. If these countries had chosen not to take any action against China, they would have lost its sovereignty completely. In the last scenario, as they are small powers, they cannot maintain control of the whole area due to military incapability. However, they at least can prevent China's complete the control over the South China Sea. Therefore, they have followed a strategy includes balancing and defending. They focused on military modernization and arm build-up against China's naval build-up and its aggressiveness. Also, they have chosen to diversify alliances with external powers against China instead of accepting its dominance.

In the framework of the neorealist assumption, Waltz argues that states will choose to balance against threats to survive. Similarly, Mearshiemer claimsthat "power is a means to an end and the ultimate end is survival" and that every actor in the system has to attempt to survive. Therefore, they are forced to make alliances and seek power to protect themselves. Also, Walt stated that anarchic structures lead even secondary states to balance with a status quo power in opposition to rising power. As secondary powers, both the Philippines and Vietnam have exhibited internal and external balancing behavior towards China.

In terms of external balancing, the strongest policy the Philippines has adopted in response to Chinese aggression in the South China Sea was their move to strengthen their relationship with the United States. The county has not limited its alliances with the US and has additionally diversified by cooperating with Japan and Russia. In this way,the country intends to strengthen its deterrence capability and increase its bargaining opportunities to become able to convince China to negotiate over the disputed areas.<sup>356</sup> For internal balancing purposes, the Philippines has increased its military spending to modernize its military. Therefore, it has improved its military capabilities and engaged to military cooperation and exercises with external powers.

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<sup>356</sup> Leszek Buszynski, "Realism, Institutionalism, and Philippine Security", *Asian Survey*, Vol. 42, No. 3 2002, p.500.

Similar to the Philippines, Vietnam has invested in improving its deterrent capacity for both internal and external balancing. For external balancing purposes, Vietnam has expanded its alliances with several countries including the US, Russia, Japan and India.<sup>357</sup> For internal balancing purposes, Vietnam has started to modernize its military, upgrading its naval, air and electronic fighting capabilities.<sup>358</sup> Vietnam has thus increased its defense budget in order to modernize its military and upgrade its defense capacity to date.

To sum up, when expedience is high in terms of survival, interdependence has proven to be unable to force the Philippines and Vietnam into adopting security policies more accommodating of Chinese interests. In the Scarborough Shoal crisis, the Philippines sent its only warship to the area and the government was clear and assertive in its intention to defend its sovereign interests. Although aware that China's superior maritime capabilities could ultimately take control of the situation at sea, the country continued to push its interests. Furthermore, in Reed bank case, a small-scaled conflict happened between China and the Philippines. Unlike Neoliberal expected, the Philippines demonstrated violence in the pursuit of its maritime sovereignty claims toward China's actions. In the case of Vietnam, when China started to operate in HYSY 981 in 2011, a small-scale conflict flared up. Vietnam reacted aggressively with no economic loss consideration. As a result, asymmetry or vulnerability did not inhibit the country's assertiveness. Therefore, in practice there is no evidence that economic interdependence has prevented the Philippines and Vietnam from behaving contrary to Chinese interests in the South China Sea dispute.

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<sup>357</sup> Zha, p. 36.

<sup>358</sup> Kaplan, p.54.



## CONCLUSION

China, after implementing liberal economic reforms, has integrated with the international economy. As a result, the country has made huge progress in economic development and become the second largest economy in the world. With the economic rise of China, its effects on economic advancement and power politics in the Asia Pacific have become a remarkable topic in contemporary international relations. After the Asian financial crisis of 1997, the region experienced economic recovery and trade and investment flow has increased dramatically. The Southeast Asian countries benefit from the opportunities provided by China for the maintenance of their economic growth. Specifically, the Philippines and Vietnam have been quite willing to take advantage of China's economic rise to the benefit of their economic development. Therefore, they strengthened their economic cooperation and ties with China through various channels. While providing broadened market access, raw materials, energy resources and intermediate products to China, they receive financial support and privileges and low tariffs. Ultimately, these developments have paved the way for increasing economic interdependence.

China is one of the biggest trade partners of the Philippines and Vietnam. In addition to trade, FDI has also played an important role in the context of economic interdependence. Chinese FDI is of vital importance for both countries' economies. In the absence of Chinese investments and financial aids, the economic growth of these countries would be interrupted, as they suffer from fragile economies and have an urgent need for capital flow. In the long run, the consequences of this interruption would be reflected also in political domain besides economic one. Through financial cooperation, China has provided significant assistance to the Philippines and Vietnam since the 1997 Asian financial crisis. China has become a stabilizing force in the Asian financial system with investment, aids and swap agreements. This condition increased the financial sensitivity of the Philippines and Vietnam as their banking relations became intertwined with China's. Moreover, bond markets are parallel to banking; thus, the maintenance of cooperation is needed for the continuation of stable growth of the Philippines and Vietnam. As those countries' national banks enjoy funds and foreign aid from China, the cost of any disruption increases for them. At this point, asking the question of whether developed economic relations have an effect on their security relations becomes important.

This study has sought to address that question by using the South China Sea dispute as a case study. Considering arguments of complex interdependence arguments, these economic developments might bring peace between the parties. Keohane and Nye have previously demonstrated that economic interdependence lead to the vulnerability of the weaker state. Thus, they tend to focus on solving their political and security problems peacefully due to the high cost of disruption in their economic relations. However, this study argues that there are significant nuances which directly affect the security relations and responses of weaker states which was ignored by Neoliberal. Also, as in the case of the South China Sea dispute, the effect of economy on states' security relations were not as the Neoliberal provisioned.

The South China Sea dispute is more than a small conflict for the claimant states as all of them relate it to their survival. This study asserted that unlike Neoliberal belief, when it comes to security and survival of the states, they are less tolerant and are ready to risk the gains of their economic relations. As neorealists explain states main motivation is to maximize their power in anarchic international

system. This argument can be considered consistent for China's and its neighbors' behaviors. China, as a rising economic power in the region while developing its economy, is at the same time trying to increase its military capabilities with a power maximization motivation. Thus, the Philippines and Vietnam's approaches toward China mostly shaped by security concerns, as there is geographical proximity and the unequal distribution of power between them. These factors create uncertainty for both the Philippines and Vietnam.

In order to understand whether economic interdependence has affected the Philippines and Vietnam's actions toward China, this study principally concentrates on reactions and policy responses of the Philippines and Vietnam against China aggression. The priority of the states is to maintain their sovereignty and protect their national interests against any external threat, although they have the developed economic relations with the aggressor state. There are several means for the weaker states to cope with major powers. The first is internal balancing, which necessitates the engagement of a weaker state with a stronger power.<sup>359</sup> In this way, a weaker state develops its military capacity, builds up arms and increases its deterrence capacity. Secondly, external balancing behavior can be considered a core of the traditional balance of power theory.<sup>360</sup> It requires making alliance with other powers against the preponderant threat.<sup>361</sup>

In this framework, the Philippines have implemented both internal and external balancing behaviors towards China. In external balancing, the strongest policy the Philippines adopted in response to Chinese aggression in the SCS was the move to strengthen its relationship with the United States. With this way, the country aimed to strengthen its deterrence capability and increase its bargaining opportunities to be able to convince China to negotiate over the disputed areas.<sup>362</sup> For internal balancing purposes, the Philippines has increased its military spending to modernize its military. Therefore, it has improved its military capabilities and engaged to military cooperation and exercises with external powers due to their security

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<sup>359</sup> Stephan M. Walt, "Alliances: Balancing and Bandwagoning", **International Politics**, (Ed. Robert J. Art and Robert Jervis), Addison-Wesley Educational Publishers Inc., New York, 2000, p.110-111.

<sup>360</sup> Walt, p.111.

<sup>361</sup> Walt, p.112.

<sup>362</sup> Leszek Buszynski, "Realism, Institutionalism, and Philippine Security", **Asian Survey**, Vol. 42, No. 3 2002, p.500.

concerns. Similar to the Philippines, Vietnam has invested in improving its deterrent capacity for both internal and external balancing in order to protect its sovereignty in the South China Sea.

Despite China-the Philippines and China-Vietnam having improved and interconnected economic relations, conflict remains inevitable due to their overlapping claims and sovereignty concerns. According to Neoliberal argument, advanced economic relations expedite to prevent conflicts between states. In both the cases of the Philippines and China, security policies and foreign policy behaviors toward each other in the South China Sea dispute make the Neoliberal assumption obsolete. In contrast with Neoliberal, Neorealists argue that states cannot solve security issues despite their developed economic relations when the issue is about their survival. This is their ultimate goal in the international system, as in order to protect themselves they may risk economic gains over sovereignty. In another words, where security interests are of greater importance, states will be willing to tolerate losses due to possible economic disruption.

To conclude, China, Philippines and Vietnam must find novel ways to address their security issues in the South China Sea in order to maintain fruitful economic relations which have had tremendous impacts on their economic welfare. It remains unknown whether these parties will be able to compromise on these issues through diplomacy instead of military conflict, as none of the claimants have forgone their rights, especially in terms of sovereignty. The Philippines and Vietnam are proactively pushing for eventual region-wide solutions to the SCS disputes, including joint development, arbitration and a multilateral solution through ASEAN. However, China is quite determined not to solve the problem multilaterally. The country insists on bilateral discussions with each country to maximize its leverage.



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