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Trends in
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THE SOUTH CHINA SEA AND
CHINA-ASEAN RELATIONS

ZHAO HONG



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Trends in Southeast Asia

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FOREWORD

The economic, political, strategic and cultural dynamism in Southeast Asia has gained added relevance in recent years with the spectacular rise of giant economies in East and South Asia. This has drawn greater attention to the region and to the enhanced role it now plays in international relations and global economics.

The sustained effort made by Southeast Asian nations since 1967 towards a peaceful and gradual integration of their economies has had indubitable success, and perhaps as a consequence of this, most of these countries are undergoing deep political and social changes domestically and are constructing innovative solutions to meet new international challenges. Big Power tensions continue to be played out in the neighbourhood despite the tradition of neutrality exercised by the Association of Southeast Asian Nations (ASEAN).

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The South China Sea and China-ASEAN Relations

By Zhao Hong

EXECUTIVE SUMMARY

- From the late 1990s until recently, China's approach to Southeast Asia and various territorial and maritime disputes was to engage in "good neighbor policy" and bilateral negotiations. In recent years, however, Beijing's actions have somewhat departed from this broadly benign approach.
- For China, energy security and maritime development are the main considerations. Moreover, China's maritime capabilities are growing rapidly, including maritime law enforcement, military power projection and offshore drilling.
- However, China is not the only country that is assertive in exploiting energy resources in South China Sea. Rising energy prices, fears of supply scarcity, and the rapid increase in oil-import dependence in China and some Southeast Asian countries have helped drive resource nationalism among regional governments.
- As tensions in the South China Sea increases, external players such as the US, India and Japan have become increasingly involved in the territorial dispute. Consequently, the issue has gone beyond territorial claims and access to energy resources, as the South China Sea becomes a focal point for rivalry among the big powers. This makes the dispute more complicated and dangerous, arousing concerns that China-ASEAN relations will be affected.
- From Southeast Asia's point of view there have been mixed signals coming from Beijing in recent years. On the one hand, China accepted guidelines on how to implement the 2002 DOC, according to which all parties pledge to seek peaceful solutions to disputes and conduct maritime cooperation in order to maintain regional stability

in the region. On the other hand, recent years have also seen China grow more assertive in terms of energy resource exploration and military activities in the South China Sea.

- From China's point of view, as a consequence of China's economic rise and diplomatic assertiveness, most ASEAN countries have China as their major trading partner and foreign investor while they depend on the US for the maintenance of the regional security order. This strategic "dual dependency" on the US and China has led to strategic ambivalence for ASEAN as a regional organization and for individual countries. This has affected their economic cooperation with China to different extents.
- Given the importance and possible conflicts in the oil and gas rich South China Sea, China and Southeast Asian countries need to further strengthen mutual trust and forge a security partnership in general and maritime cooperation more specially.

The South China Sea and China-ASEAN Relations

By Zhao Hong¹

INTRODUCTION

The threat of China looms large in the history of relations between China and Southeast Asian countries. In the early 1990s China pursued a new post-Cold War strategy characterized by its “good neighbor policy” which aimed to turn Southeast Asia into a showcase for its “peaceful rise” strategy. At the same time, the Association of Southeast Asian Nations (ASEAN) pursued a diplomatic campaign to engage rather than isolate China. It did so by using ASEAN-centric regional architecture to socialize China to the norms of regional discussion, rulemaking, and legal compliance. The turning point for ASEAN’s perceptual change of China from “threat” to “opportunity”, many Chinese analysts believe, came during the Asian financial crisis in 1997-1998.² In that crisis, China firmly committed not to devalue its currency and also provided timely economic and financial assistance to some ASEAN countries, both bilaterally and multilaterally. Over time, especially in 2000-2010, China has used trade and investment, confidence-building measures, and development assistance to establish itself as a responsible regional leader. This was most clearly reflected in its proposed establishment of the China-ASEAN FTA (CAFTA), which came into force on 1 January

¹ Zhao Hong is a Visiting Senior Fellow at ISEAS; email: zhao_hong@iseas.edu.sg.

² Chinese scholars consider the financial crisis a watershed regarding ASEAN countries’ perceptions of China. 1997 is the landmark to indicate the rise of China’s soft power in Southeast Asia. [Chen Xiansi, “On China’s soft power in Southeast Asia”, *China’s Foreign Affairs*, no.5, 2007, pp.32-33].

2010, and its support of ASEAN+3 and ASEAN+6 FTAs. Moreover, China accepted the ‘ASEAN Way’ as diplomatic principle and strove to take its neighbors’ interests into account. During the same period, due to the good relations and China’s acceptance of multilateralism, including the agreement to engage ASEAN as a group, the South China Sea was not a major issue.

However, already in 2008, China began pursuing a more assertive foreign policy. The Chinese economy had rebounded quickly and strongly from the global downturn, and this led to the realization amongst Chinese policymakers of the fact that territorial disputes had hardly slowed the pace of economic cooperation, resulting in a new confidence among Chinese leaders in their ability to deal with the West and settle territorial disputes on their own terms.³ More concretely, China began extending its military reach, and consolidating its jurisdictional claims in the South China Sea. On the other hand, with ASEAN countries increasingly concerned with China’s “creeping assertiveness”, some of the claimant countries in the South China Sea dispute have invited the involvement of the US and welcomed US efforts to revitalize bilateral military ties with countries like Japan, the Philippines, and Vietnam. Consequently, the issue has gone beyond territorial claims and access to energy resources, as the South China Sea has become a focal point for rivalry among the big powers. Since 2010, the sea has become linked to wider strategic issues relating to the American “rebalance strategy”, Indian “look east strategy”, and Japanese “counter China strategy”. This makes the dispute more complicated and dangerous, arousing concerns that the advancement of China-ASEAN relations will be affected.

CHINA ADJUSTS ITS SOUTH CHINA SEA POLICY

From the late 1990s till recently, China’s approach to Southeast Asia and various territorial and maritime disputes was to engage in “good neighbor

³ Prashanth Parameswaran, “Challenged by China, ASEAN states seek common response”, *ChinaBrief*, Volume XIV, Issue 10, 23 May 2014.

policy” and bilateral negotiations. To alleviate suspicion and resistance and create a peaceful international environment for its modernization programmes, China followed a low-profile policy and avoided confronting the US and ASEAN countries while its economy began taking off rapidly in the late 1990s and early 2000s. For this and other reasons, Beijing made the effort to be benign and charming to Southeast Asia, and adhere to Deng Xiaoping’s guidance of “shelving the disputes (of sovereignty) and working for joint development”.

In recent years, however, Beijing’s actions have somewhat departed from this broadly benign approach and has become “assertive” in terms of energy resource exploration and frequent military activities in disputed territories. It has renewed its claims over certain areas and forcefully expanded its maritime law enforcement in the South China Sea by sending “combat-ready” patrol ships regularly to escort fishing fleets and conducting naval exercises in disputed areas of the South China Sea. Moreover, on 9 January 2014, Beijing announced that all foreign vessels could fish in the South China Sea only after permission had been granted by the relevant local authorities.⁴ A law passed at the People’s Congress of Hainan province in November 2013 provided legal justification for the new fishing regulation.

For China, energy security and maritime development are the main considerations. The recent crises and turmoil in Sudan, northern Africa and the Middle East have affected China’s overseas energy-strategic areas, posing potential constraints and raising costs. For example, because of the outbreak of the civil war in Sudan, China’s imports of crude oil from both North and South Sudan decreased from 13 million tons in 2011 to 2.5 million tons in 2012, a drop of 80 percent.⁵ A large amount of China’s energy facilities and infrastructures were also damaged. Moreover, China’s energy consumption structure relies mainly on coal, which has resulted in a series of problems including environmental pollution and climate change. China was propelled to further implement

⁴ Richard Javad Heydarian, “China casts red tape in South China Sea”, *Asia Times Online*, 15 2014.

⁵ China Customs Statistics 2012.

its energy diversification strategy, and shift its oil and gas development focus to the oceans. Moreover, China's maritime capabilities are growing rapidly, including maritime law enforcement, military power projection and offshore drilling. China has invested considerably in becoming a "maritime power" following the 12th Five Year Plan (2011-2015) which calls for the national maritime economy to compose 10 percent of China's total GDP.

Domestically, the Communist Party of China (CCP) is facing pressure from rising nationalism on its South China Sea policy. For example, some Chinese scholars argue that while other countries have been actively exploring oil resources in South China Sea for decades, China had not drilled any well, nor produced a drop of oil from the region. They hold that "the current passive situation of China in the South China Sea is largely due to its slow resource development process there,"⁶ and while China abides by Deng's "shelving territorial differences and engaging in joint development", Vietnam and the Philippines do not limit themselves in any such way. In fact, these scholars believe that Vietnam and Philippines "are taking advantage of joint development while shelving sovereignty to compress the expanding space of China's geo-economic strategy in the South China Sea".⁷ Hence, China must accelerate the speed of its development in the South China Sea if it is not to lose out to these countries.⁸ These scholars call for the stepping up of development and exploration of South China Sea resources so as to "show China's ability to manage the South China Sea, and hence change such an embarrassing

⁶ Li Jin Ming, "nanhai wenti xianzhuang jiqi yingdui" (Current South China Sea issue and counter-measures), *Journal of Modern International Relations* (xiandai guoji guanxi), No.8, 2012.

⁷ Wu Yin and Tang Jian, "Geo-economic strategy in the South China Sea", in *China-Neighboring Asian Countries Relations: Review and Analysis*, edited by Li Xiangyan, Social Science Academic Press, China, 2013, P.153.

⁸ An ying-min, "Lun nanhai zhengyi quyue youqi ziyuan gongtong kaifa de moshi xuanze"(On the mode of jointly developing oil and gas in South China Sea), *Journal of Contemporary Asia-Pacific* (Dangdai yatai), No. 6, 2011, pp.124-140.

situation that China has not drilled any well, nor produced a drop of oil in South China Sea.”⁹ It is often suggested that Chinese leaders are moderate in their views, but have to take into account the emotional nationalism of young Chinese, especially as expressed on the internet.¹⁰

CHINA’S SEARCH FOR MARITIME ENERGY RESOURCES

Under such circumstances, the search for energy resources in the adjacent waters and the participation of its oil companies in offshore oil and gas projects have become an inevitable trend for China. Related ministries and departments in China have likewise attached great importance to the development and utilization of oil and gas resources in the South China Sea, suggesting that the South China Sea will become a main source of China’s oil and gas supply in the future.

China is currently Asia’s largest offshore energy producer, followed by Malaysia, Vietnam, and Indonesia. China’s offshore oil production recently reached more than 600,000 barrels per day, accounting for about 15 percent of China’s total oil production.¹¹ Before 2012, China’s energy exploration was primarily confined to shallow waters adjacent to its southeastern coast. *Table 1* below shows the production figures for China National Offshore Oil Corporation (CNOOC), the country’s main offshore oil and gas producer. The Bohai Gulf is presently China’s core offshore production zone in terms of oil output. But deep-sea capability has become necessary as China seeks to bolster its energy security, a search that has taken place alongside its desire to reshape the political and security environment in the South China Sea. The South China Sea is set to become an important oil and gas source as it is believed that “Beijing sees deep-sea exploration as an important tool to substantiate

⁹ Li Jin Ming, “nanhai wenti xianzhuang jiqi yingdui” (Current South China Sea issue and counter-measures), *Journal of Modern International Relations* (xiandai guoji guanxi), No.8, 2012.

¹⁰ Wang Jisi, “China’s search for grand strategy: a great power finds its way”, *Foreign Affairs* 90(2), March/April 2011.

¹¹ CNOOC Annual Report 2010, 2011, <<http://www.cnooltd.com>>.

Table 1 CNOOC's oil and gas production in adjacent waters

	2005	2006	2007	2008	2009	2010	2011
Net production of crude and liquids (barrels/day)							
Bohai Bay	178,840	200,944	206,748	218,478	253,884	408,946	405,682
Western South China Sea	49,016	40,437	34,163	56,761	72,605	84,116	72,006
Eastern South China Sea	103,741	105,902	103,715	122,813	118,391	121,454	120,563
East China Sea	1,706	1,464	1,467	85	63	53	339
Overseas	23,565	23,973	25,735	23,931	64,749	90,419	83,993
Total	356,868	372,720	370,433	422,068	509,606	704,988	682,583
Net production of natural gas (million cubic feet/day)							
Bohai Bay	49.1	64.5	70.2	74.5	79.2	120.4	123
Western South China Sea	229.6	251.8	237.3	284.7	275.4	354	390.4
Eastern South China Sea	—	23.1	27.4	28.1	50.2	139.5	157.8
East China Sea	18.3	21.2	8.7	6.8	6	5.5	18.7
Overseas	92.7	130.3	200.7	227	242.7	332.2	345.3
Total	389.6	490.9	544.3	621.1	653.5	951.6	1,035.2

Source: CNOOC Annual Report 2010, 2011,
 <<http://www.cnoocld.com>>, [accessed on 11 January 2014]

China's physical presence in the disputed waters".¹² China is targeting oil and gas production of 500,000 bpd of oil equivalent by 2015 and 1 million bpd of oil equivalent by 2020 in 3,000-metre deep-sea areas of the South China Sea.¹³

To bolster Beijing's strategy, the CNOOC has focused in the last few years on developing its deep-sea exploration capability. Though still in its early stages, CNOOC has partnered foreign companies and increased indigenous development to expand its technological reach. In May 2012, CNOOC began its first deep-sea project in an undisputed area of the South China Sea, southeast of Hong Kong. Erica Downs, an American scholar with the Brookings Institute, has claimed that the deployment of CNOOC's new rig indicates that CNOOC is beginning to close the gap with major international oil companies in deep-water drilling.¹⁴ Currently CNOOC is equipped with two deep-sea oil platforms, CNOOC 981 and Nanhai VIII, which will drill in water depths of up to 3,000 metres (9,800 feet) and 1,400 metres, respectively.¹⁵

ASEAN COUNTRIES' EXPLORATION ACTIVITIES

China is not the only country that is assertive in exploiting energy resources in the South China Sea. In fact, Vietnam, the Philippines, Malaysia, and Singapore were already actively exploiting oil resources after they were discovered in the South China Sea in the 1960s. There were hundreds of platforms in the Spratly Islands area, and according to China's data,

¹² Stratfor Global Intelligence, "China uses deep-sea oil exploration to push its maritime claims," <<http://www.stratfor.com/analysis/china-uses-deep-sea-oil-exploration-push-its-maritime-claims>> [access on 14 May 2014].

¹³ Wang kang-peng, "zhonghaiyou shiyou meng", (CNOOC's oil dream) <<http://china5e.com/show.php?contentid-160243&page=3>>.

¹⁴ "Picking apart nationalist rhetoric around China's new oil rig," *The Wall Street Journal*, 11 May 2012.

¹⁵ Stratfor Global Intelligence, "China uses deep-sea oil exploration to push its maritime claims," <<http://www.stratfor.com/analysis/china-uses-deep-sea-oil-exploration-push-its-maritime-claims>> [access on 14 May 2014]

more than 50 million tons of oil are extracted per year.¹⁶ Vietnam and the Philippines are the most active in their exploration activities, seeking cooperation with international oil and gas companies.

Vietnam

In 2011, state-owned PetroVietnam produced 30 million tons, or 27 percent of the country's total production from three fields in the South China Sea.¹⁷ Chinese experts on Vietnam are concerned over Hanoi's efforts to develop a comprehensive ocean strategy.¹⁸ The fourth plenum of the Tenth VCPCC held in January 2007 endorsed an "Ocean Strategic Program to 2020," reflecting ambitions to make Vietnam a "maritime major power." By 2020, the goal was for Vietnam's oceanic economy to provide 53 to 55 percent of its GDP, with ocean exports amounting to 55 to 60 percent of total exports.¹⁹ To realize these ambitions, Vietnam has had incentive to involve as many foreign partners as possible to reinforce its claims in the area and to deter Chinese opposition.²⁰ The most striking evidence is the fact that in 2013, US-based ExxonMobil and PetroVietnam announced plans to build a US\$20 billion power plant to be fueled by oil and gas from two exploratory areas, which are west

¹⁶ Wu Yin and Tang Jian, "Geo-economic strategy in the South China Sea", in *China-Neighboring Asian Countries Relations: Review and Analysis*, edited by Li Xiangyan, Social Science Academic Press, China, 2013, p.153.

¹⁷ "Vietnam: PetroVietnam finds more oil at Bach Ho field offshore Vietnam", *Energy-Pedia News*, 29 June 2012 <<http://www.energy-pedia.com/news/vietnam/vietsovpetro-finds-more-oil-at-bach-ho-field-offshore-vietnam>>.

¹⁸ Yu Xiangdong, "Yuenan quanmian haiyang zhanlue de xingcheng shulue" (A brief account of the formulation of Vietnam's comprehensive ocean strategy), *Journal of Contemporary Asia-Pacific Studies*, No.5, 2008, pp.100-10.

¹⁹ Joseph Y.S. Chen, "Sino-Vietnamese Relations in the Early Twenty-first Century: Economics in Command?", *Asian Survey*, Vol.51, No.2, pp.379-405.

²⁰ Leszek Buszynski and Iskandar Sazlan, "Maritime Claims and Energy Cooperation in the South China Sea", *Contemporary Southeast Asia*, Vol. 29, No.1, 2007, pp.141-171.

of the Parcel Islands but within Vietnam's Exclusive Economic Zone (EEZ).

Another country which has increasing involvement in oil and gas exploration with Vietnam is India. India's OVL (Oil and Natural Gas Commission Videsh Limited) – a state-owned company under the Ministry of Oil and Natural Gas – has been present in Vietnam for some time, participating in a major oil venture for offshore oil and gas exploration. India has already invested and holds a stake in a block located 370 kilometers southeast of Vung Tau on the southern Vietnamese coast with an area of 955 square km. The exploration license for this block was acquired by OVL in 1988. The field started commercial production in January 2003. During 2010-2011, OVL's share of production from the project was 2.249 billion cubic meters (bcm) of gas and 0.038 million metric tons of condensate.²¹

Later in 2006, OVL acquired two more blocks in the South China Sea for hydrocarbon exploration. Block 127 is an offshore deep-water block, located at water depth of more than 400 meters with an area of 9,246 square km. OVL had invested around US\$68 million by March 2010. An exploration well was drilled in July 2009 to a depth of 1,265 meters. As there was no hydrocarbon presence, OVL decided to return the block to PetroVietnam.²² The second, Block 128, was also acquired at the same time. The OVL had invested approximately US\$49.1 million by March 2012. As in the case of Block 127, the well in Block 128 could not be drilled by rig either, because of anchoring difficulties²³ Vietnam has been persuading India to drill in Block 128, asserting that it is within its territorial waters.

China has protested against the exploration activities of OVL around the Parcel Islands. OVL takes the view that Vietnamese claims are in accordance with international law, and it will continue with exploration

²¹ Annual Report of ONGC Videsh Limited 2010-2011.

²² Rup Narayan Das, "India in the South China Sea: commercial motives, strategic implications", *ChinaBrief*, vol. xiii, issue 18, 12 September 2013.

²³ *Ibid.*

projects in two blocks near the Paracel Islands.²⁴ In October 2011, a three-year agreement for cooperation in oil and gas exploration and production was concluded between ONGC and PetroVietnam. There was also an MoU signed, in which the seven oil blocks in the South China Sea were offered to India (including three on an exclusive basis) as well as joint prospecting in some Central Asian countries with which both Hanoi and New Delhi have good political ties.²⁵ According to *The Global Times*, “Vietnam’s granting of these seven oil blocks in the South China Sea to India for exploration is part of a plan to internationalize Hanoi’s territorial dispute with China.”²⁶

Philippines

For the Philippines, the urgency of developing marine resources is great as well. From the perspective of per capita resource, the pressure it faces is greater than that for China. The Philippines’ population density is 342 persons per square kilometer, while China’s is 140. Therefore, in the Philippines there is general consensus on the importance of marine resources for its national economy.

In terms of energy supply and demand, according to the International Energy Agency (IEA), the Philippines’ primary energy demand stood at 40 mtoe (million tons of oil equivalent), and is projected to grow at an average rate of 3.5 percent per year from 2011 to 2035.²⁷ Oil accounted for 35 percent of Philippines total primary energy consumption in 2011. The country’s oil consumption in 2012 was 282,000 bpd (barrels per day), but its production in 2008 was only 23,000 bpd, most of which was from the Malampay and Palawan fields in the South China Sea.²⁸ Moreover,

²⁴ Ananth Krishnan, “South China Sea projects an infringement on sovereignty, says China”, *The Hindu*, 19 September 2011, <<http://www.thehindu.com/news/international/article2468317.ece?css= = print>>.

²⁵ Ibid.

²⁶ *The Global Times*, 17 September 2011.

²⁷ IEA, *Southeast Asia Energy Outlook*, September 2013, p. 57.

²⁸ BP Statistical Review of World Energy June 2013; IEA, *World Energy Outlook 2009*, p. 615.

Philippines's relations with Arab countries and Indonesia are complex due to domestic political and religious reasons, resulting in an unstable energy supply. Therefore, the Philippines wants to expand its domestic oil production to reduce its almost total reliance on oil imports.

The Philippines has ambitious goals for its energy strategy and has attempted to boost self-sufficiency in oil production. It had intended to offer 15 exploration contracts over the next few years for offshore exploration off Palawan Island in an area claimed by China.²⁹ More prominently, the Philippines is seeking to develop the seabed hydrocarbon resources of Reed Bank in the South China Sea, an area under dispute with China. On May 2014, the Philippines' Department of Energy launched a tender for exploration rights to 11 oil and gas blocks, and Philex Petroleum Corp of the Philippines announced that its London-listed unit, Forum Energy Plc, plans in early 2016 to start drilling appraisal wells in the Sampaguita gas field, also at Reed Bank.³⁰ Should the Philippines proceed to develop Reed Bank unilaterally, there is a likelihood that tensions between the two countries will escalate.

In the Chinese view, this 'joint development' between different countries has compressed China's geo-economic space in the South China Sea. As Chi Fulin, Dean of China (Hainan) Reform and Development Research Institute, observes, "a wide range of oil and gas wells of other countries have indirectly claimed sea area of more than 1.5 million square kilometers, all of which is disputed by China and peripheral countries around the South China Sea; consequently, only a sea area of 440,000 square kilometers is left for China, which only accounts for 22 percent of China's claimed sea area within the South China Sea".³¹ Moreover,

²⁹ "Philippines to seek more oil in West Philippine Sea", *Inquiry Global Nation*, 29 June 2012 <<http://globalnation.inquirer.net/5034/philippines-to-seek-more-oil-in-west-philippine-sea>>

³⁰ Christopher Len, "Reed Bank: South China Sea flashpoint", *AsiaTimes online*, 3 June 2014.

³¹ Chi Fulin et al, "Development program in the South China Sea and construction of Hainan Strategic base – proposals for China's 'Eleventh-Five' plan", *Review of Economic Research*, 2005, No.51.

Chinese scholars believe that these long-term joint development projects will easily result in a ‘fait accompli’ for China’s geo-economic strategic space in the South China Sea, and thus increase the vulnerability of China’s geo-economy in the area.³²

EXTERNAL PLAYERS IN THE SOUTH CHINA SEA

As tensions in the South China Sea increases, external players such as the US, India and Japan have become increasingly involved in the territorial disputes, either for their own energy and strategic reasons, or because of ASEAN countries’ need to balance China’s influence.

The United States

For a long time, the US position on South China Sea disputes was neutral, with Washington insisting that it did not take sides in territorial disputes and had no stake in them. The US supports ASEAN initiatives with respect to the Declaration on the Conduct of Parties in the South China Sea (DOC) and Code of Conduct (COC). In 2002, ASEAN and China agreed on the DOC, which is a set of principles that was supposed to stabilize the status quo, though it is non-binding and lacks any enforcement mechanism. ASEAN’s 2011 leader, Indonesian President Bambang Susilo Yudhoyono, stated at the Association’s 44th Ministerial Meeting in July that the ASEAN Regional Forum (ARF) should “finalize the long overdue guideline because we need to get moving to the next phase, which is identifying elements of the COC.” The US insists that all parties should accelerate efforts to agree on a full COC for the South China Sea.

Beginning at the ARF in July 2010, the Obama administration decided to play a larger role in bringing about a resolution to the Spratly Islands imbroglio, while making the point that South China Sea stability

³² Wu Yin and Tang Jian, “Geo-economic strategy in the South China Sea”, in *China-Neighboring Asian Countries Relations: Review and Analysis*, edited by Li Xiangyan, Social Science Academic Press, China, 2013, P.154.

for maritime commerce constituted a significant US interest.³³ At the July 2010 ARF, Secretary of State Hillary Clinton affirmed in relation to this issue that “The US, like every other nation, has a national interest in freedom of navigation, open access to Asia’s maritime commons, and respect for international law in the South China Sea. We share these interests not only with ASEAN members and ARF participants but also with other maritime nations and the broader international community.”³⁴ This suggested that the US had adopted a stance on the South China Sea issue that was similar to its position on the Diaoyu/Senkaku dispute between China and Japan in the East China Sea, allowing also for the security commitment of US to Japan.

The US holds that territorial disputes must be resolved according to international law, meaning the 1982 United Nation Convention on the Law of the Sea (UNCLOS), which has rules for fixing maritime boundaries via EEZ. Application of these principles would invalidate China’s claims to most of the South China Sea while favoring the littoral states. In addition, Washington has become a strong backer of ASEAN’s multilateral negotiation posture, strongly urging China to compromise in multilateral talks with its ASEAN counterparts to find a solution to the disputes. However, Beijing prefers to work through bilateral talks. After all, the US has a security treaty with the Philippines which could potentially draw the US into the conflict. The US’s emphasis on multilateral diplomacy for the South China Sea underlines the hope that ASEAN as a whole will be more involved and play a supra-national diplomatic role in efforts to resolve the disputes. But in fact, even within ASEAN, the features claimed by Malaysia, the Philippines, and Brunei are also claimed by Vietnam. So not only are these claimants aligned against China but also against each other. Moreover, ASEAN states take varying positions on the disputes: Laos, Cambodia, and Myanmar lean towards China; Malaysia and Indonesia are cautious about US

³³ Sheldon W. Simon, “Conflict and Diplomacy in the South China Sea”, *Asian Survey*, Vol.52, Number 6, 2012.

³⁴ Cited in *ibid*.

involvement; Thailand and Singapore are neutral; while both Vietnam and the Philippines welcome an American role.³⁵ Hence, it should not be surprising if these disputes cause division and divergence among ASEAN countries.

Japan

Though a non-claimant state, Japan is greatly concerned over the South China Sea disputes. There are Japanese perceptions of a linkage between the South China Sea and East Asia Sea disputes, and that Beijing's strategy and actions towards the claimant states in the South China Sea may have implications for the East China Sea and the Diaoyu/Senkaku dispute. Thus, to seek a more active political role in the South China Sea dispute, Japan is strengthening its diplomatic and defense ties with the Philippines and Vietnam, and using multilateral institutions like the ARF and the EAS (East Asian Summit) to check perceived Chinese assertiveness in the South China Sea. In September 2011, Japanese and Philippine officials discussed the creation of a "permanent working group" to coordinate their policies pertaining to Asian maritime disputes.³⁶

As the situation in the South China Sea intensified in 2014 with China's Hai Yang 981 oil rig being deployed to disputed waters, Prime Minister Shinzo Abe pledged at the Shangri-La Dialogue held in Singapore on 30 May 2014 to support Vietnam and the Philippines in their territorial disputes with China, saying that Japan will provide patrol vessels to these two countries.³⁷ This suggests that Japan under Abe is ready to assist Southeast Asian states with its claims in order to monitor and fend off China, and is determined to become a regional security leader or co-

³⁵ Sam Bateman, "Managing the South China Sea: sovereign is not the issue," Rajaratnam School of International Studies (RSIS), *RSIS Commentaries*, no.136/2011, 29 September 2011.

³⁶ Sheldon W. Simon, "Conflict and Diplomacy in the South China Sea", *Asian Survey*, Vol.52, Number 6, 2012.

³⁷ Kyodo, "Abe backs up ASEAN on maritime security, prods China", *The Japan Times*, 30 May 2014.

leader for Southeast Asia.³⁸ The easing of the arms export restrictions in 2011 may have played a role in the pledge to transfer these vessels for the purpose of helping the Philippines and Vietnam enhance their maritime security. Moreover, according to political analyst Alex Magno, Tokyo's decision to re-interpret Japan's pacifist Constitution and allow its right to collective self-defense would "encourage Abe to establish a military alliance with the Philippines and Vietnam, a Tokyo-Manila-Hanoi axis".³⁹ While countries like the Philippines and Vietnam who are locked in their territorial disputes with China may welcome military assistance from Japan, this may be harder to do for countries like Malaysia and Indonesia who understand that backing Abe's vision for Japan's regional role may upset their relations with China.⁴⁰

Besides strengthening ties with the Philippines and Vietnam, Japan has sought to use the ARF and EAS to deal with the South China Sea dispute. For example, in October 2011, Japanese Foreign Minister Gemba Koichiro proposed that a maritime regime be considered at the EAS meeting to be held in Bali the following month.⁴¹ The intention was a multilateral approach, which included Japan and ASEAN's dialogue partners, towards the construction of a maritime regime in the South China Sea based on freedom of navigation, international law and peaceful settlement of disputes. Not surprisingly, Tokyo's attempts to build a new maritime architecture for the South China Sea has been viewed as "muddying the water" by Beijing.⁴² The more Japan confidently inserts

³⁸ Rober Ayson, "Japan steals the show at the Shangri-La Dialogue", *East Asia Forum*, 13 June 2014.

³⁹ Quoted from Raul Dancel, "Historic shift in Japan's military role", *The Strait Times*, 3 July 2014.

⁴⁰ Rober Ayson, "Japan steals the show at the Shangri-La Dialogue", *East Asia Forum*, 13 June 2014.

⁴¹ "Editorial: Government must boost security, economic ties with ASEAN", *Daily Yomiuri*, 15 October 2012.

⁴² "Japan muddies the waters in the South China Sea", *China Daily*, 10 October 2011.

itself into South China Sea disputes, the more Tokyo's enmity with Beijing becomes a part of the wider picture.

India

India is not a party to the South China Sea dispute but it is increasingly engaged in the region. Its strategic expansion from the Indian Ocean into the South China Sea may be understood along several dimensions. First, it desires to become an Asian power, not just an Indian Ocean actor. Second, India, after considerable investment in its navy, now has the capability to deploy its forces in eastern Asia and balance China – now not only from along the Sino-Indian land border but at sea as well. Third, India is investing in South China Sea energy exploration for its rapidly developing economy. With China-ASEAN ties under stress due to Beijing's territorial claims, New Delhi has been trying to fill the void by emphasizing its credentials as a responsible regional stakeholder. The most striking evidence that India is interested in South China Sea energy resources is its joint exploration with Vietnam.

NEGATIVE IMPACTS OF SOUTH CHINA SEA DISPUTES

Southeast Asian perceptions

From Southeast Asia's point of view, there have been mixed signals coming from Beijing in recent years. On the one hand, China accepted guidelines on how to implement the 2002 DOC suggested by ASEAN, according to which all parties pledge to seek peaceful solutions to disputes and conduct maritime cooperation in order to maintain regional stability in the region. On the other hand, the past years have also seen China grow more assertive in terms of energy resource exploration and military activities in the South China Sea. ASEAN recognizes that China prefers to use its size to dominate its regional relationship by focusing on bilateral ties or on regional structures that China can dominate. This has destroyed mutual trust and has added to the worries of ASEAN claimant countries, resulting in ASEAN becoming more pragmatic by emphasizing a hedging strategy with regards to China.

Philippines

Among ASEAN countries, the Philippines has been particularly affected by threat perceptions of China. In many Filipinos' view, China's political system is seen to be widely divergent from their own. Decades of Cold War anti-communist ideological posturing have contributed to a high degree of mistrust of the Chinese state. Seeing religiosity and spirituality to be integral to their identity, Filipino's view of China as an atheist society also adds to the ideological distance and anxiety over China.⁴³ The Philippines perceives China's assertive stance on territorial and maritime jurisdictional disputes in the South China Sea, demonstrated especially in military terms, as a threat. Manila believes that China's control of Mischief Reef and other reefs after the late-1990s constitutes a threat to its national security, and is thus impelled to rely on the US military to balance China's behavior in the South China Sea.⁴⁴ In October 1995, former Philippines President Ramos delivered a speech at the East-West Center in Hawaii postulating that China posed a threat to regional security and calling on the US to retain its military presence in Asia. He said "even if Beijing does not have the capability to expand beyond its borders, China will inevitably be a political and military threat to Southeast Asia".⁴⁵

Today, due to the recent escalation of territorial disputes, there is still outright anxiety and concern over China's strategic role in the region where a degree of wariness toward this major power is evident even among ordinary people. For example, the Pew Research Global Attitudes Survey released in 2013 showed that China's favorability in the eyes of Philippine respondents decreased from 63 percent in 2002 to 48 percent

⁴³ Aileen San Pablo-Baviera, "The Philippines in China's soft power strategy", *ISEAS perspective*, 3 June 2013.

⁴⁴ David G. Wiencek and John C. Baker, "Security Risks of a South China Sea Conflict", in John C. Baker and David G. Wiencek, eds, *Cooperative Monitoring in the South China Sea: Satellite Imagery, Confidence Building Measures, and the Spratly Island Disputes*, U.S.A.: Praeger Publishers, 2002, p.54.

⁴⁵ *Tulay* (Philippines), November 6, 1995.

in 2013, and only 22 percent of Philippines think of China as more of a partner, in contrast to America at 81 percent.⁴⁶ Renato Cruz De Castro, an expert on the Philippines, believes that “as a close neighbor of China, the Philippines has not yet totally trusted Beijing. Manila still considers Washington as the least dangerous among the big powers, the best balancer, and the most reliable insurance against an emerging China.”⁴⁷ Meanwhile Philippine Foreign Minister Albert Del Rosario has also stressed that the “US is the sole strategic partner of the Philippines”.⁴⁸ From security and strategic perspectives, as smaller and weaker parties to the South China Sea disputes, the Philippines and Vietnam have strong incentives to solicit for American support to counter China’s expansion there. “The Philippines has no choice but to rely on ASEAN and redefine U.S.-Philippines relations”.⁴⁹

Subsequently, in line with the Obama administration’s “return to Asia” strategy, the Philippines has been trying to demonstrate that it accords high priority to relations with the US. At the height of Manila’s territorial disputes with China in the first half of 2012, the US sent a strong signal of support for the Philippines, speaking out on the issue at several ASEAN forums, selling the Philippines a decommissioned Hamilton-class coast guard cutter in October 2011, and promising another one, increasing troop rotations and joint training in the Philippines, and committing to expanding port visits and joint exercises between US and Philippines navies. All these have led to a new plateau of distrust and tension in Philippine-China relations.

⁴⁶ Global Indicators Database, <<http://www.pewglobal.org/database/indicator/24/country/173/>>.

⁴⁷ Renato Cruz De Castro, “Balancing Gambits in Twenty-First Century Philippine Foreign Policy Gains and Possible Demise?”, in *Southeast Asian Affairs 2011*, p. 240.

⁴⁸ Jerry E. Esplanada, “Del. Rosario defines 3 pillars of foreign policy”, *Philippine Daily Inquirer*, March 3, 2011.

⁴⁹ Dai Fang and Jin Shi-Yong, “anquan yu fazhan: feilibin dui hua zhengce yanjiu” (Security and development: a study on Philippines’ China policy), *Southeast Asian Affairs*, no. 3, 2009.

Vietnam

Hanoi's traditional response to China's behavior in the South China Sea has been a two-pronged policy of 'hedging': that is, pursuing engagement along with indirect balancing on one hand, while trying to maintain a balanced relationship between powers without firmly plumping for any, on the other.⁵⁰ However, China's recent hardline approach on its territorial disputes has pushed Vietnam towards a more active hedging strategy. There appears to be a relative consensus within Vietnam's leadership to hedge against China's influence, and this has been perceived as an opportunity by the Obama administration for its "return to Asia" strategy.

Although Vietnam-US relations cannot go much further beyond the constraints imposed by both Vietnamese concern of Chinese reactions and the US Congress which has hindered the government's effort to build closer ties with Vietnam, a number of notable visits have taken place in recent years. In August 2011, the two countries concluded their first military agreement since the Vietnam War; though this was limited to cooperation in health and research collaboration in military medicine, it is likely to open the door to other agreements.⁵¹ In June 2012 when visiting Vietnam, US Defense Secretary Leon Panetta urged Vietnam to host more US military craft "as the US would shift emphasis to Asia by working with partners like Vietnam".⁵²

In early May 2014, China deployed the drilling platform Hai Yang Shi You 981 in disputed waters in the South China Sea, causing a wave of protests in Vietnam. After the oil rig deployment incident, in addition to soliciting support from ASEAN, Vietnam has been trying to enhance ties with important partners such as the US, the Philippines and Japan.

⁵⁰ Hoang Oanh, "Vietnam's deft diplomatic footwork on the South China Sea", *East Asia Forum*, 7 June 2014.

⁵¹ "US, Vietnam start military relationship", *DefenseNews*, 1 August 2011, <<http://www.defensenews.com/article/20110801/DEFSECT03/108010307/U-S-Vietnam-Start-Military-Relationship>>

⁵² Lien Hoang, "US, Vietnam inch closer together", *AsiaTimes online*, 12 June 2012.

The most symbolic act was its decision to participate in the Proliferation Security Initiative (PSI) after more than ten years of consideration since the initiative was launched in 2003. Vietnam had been reluctant to support the initiative, which it sees as outside the United Nations' framework. The announcement by Vietnam's foreign minister that his country will join the PSI, combined with its commitment to enhance cooperation with the US in maritime security, and the US promise of providing US\$18 million of aid to the Vietnamese coast guard, all signify an increased level of mutual trust in the Vietnam-US security cooperation.⁵³

Indonesia

Jakarta was unaffected by the territorial disputes in the South China Sea during the 1990s. Nevertheless, Indonesia, which often perceives itself as the leader of the region, was concerned over the potential of the territorial disputes to affect regional political stability. In March 1995, conflicts over Mischief Reef between Beijing and Manila led to renewed concern over Beijing's intentions. Indonesia was concerned that China's claim in the South China Sea might also infringe upon Indonesian sovereignty over Natuna Island. In this context, it had expressed its reservations over the rise of China's military capability and how China would use it in the future.⁵⁴ Jakarta soon began to pay attention to the Natuna islands. This was especially so after China was reported to have included this oil-rich area into a map detailing its claims over the South China Sea.⁵⁵

Although Indonesia's position has officially not changed, external pressures and events may have compelled Jakarta to gradually amend its stance. Indonesia was the only ASEAN country that told Beijing earlier this year that Jakarta would not accept a Chinese air defense identification

⁵³ Hoang Oanh, "Vietnam's deft diplomatic footwork on the South China Sea", *East Asia Forum*, 7 June 2014.

⁵⁴ Rizal Sukma, "Indonesia-China Relations: The Politics of Re-engagement", *Asian Survey*, Vol.49, No.4, 2009.

⁵⁵ Leo Suryadinata, "South China Sea: is Jakarta no longer neutral?", *The Strait Times*, 24 April 2014.

zone over the South China Sea. In a significant policy shift, Indonesian officials on 12 March 2014 announced that China's nine-dash line map outlining its claims in the South China Sea overlaps with Indonesia's Riau province, which includes the Natuna Island chain.⁵⁶ Should Jakarta's posture shift to become a party to South China Sea disputes, this would have tremendous repercussions on the region's geopolitics, leading to a potential change in the game being played out in the South China Sea".⁵⁷

At stake for Indonesia is not only the Natuna Islands and surrounding waters, but also the sanctity of UNCLOS. Indonesia is the world's largest archipelagic state and it lacks the naval capacity to defend its far-flung archipelago, which spans 4,800 kilometers from east to west. It has therefore always been a strong advocate of UNCLOS. In Indonesia's view, in recent years China has taken a series of actions that undermine UNCLOS and threatened regional stability. First there was China's 2009 publication of its nine-dash line map, which includes parts of the Natuna Island EEZ in its southernmost area. Indonesia protested against China's claims in 2010, and also requested that China clarify its claims by providing precise coordinates. Second, China has recently become assertive in pursuing its claims. Most critically from the Indonesia perspective, China has expanded its naval exercises from its northern claims closer to mainland China down to its southern ones. In 2010, for example, after an Indonesian patrol boat captured a Chinese vessel fishing within its EEZ, the Chinese dispatched the *Yuzheng 311*, compelling the Indonesian patrol boat to release the Chinese vessel. Similarly in March 2013, Indonesian officials boarded a Chinese vessel fishing in the Natuna

⁵⁶ On 12 March 2014, Indonesia's Commodore Fahu Zaini, assistant deputy to the chief security minister for defense strategic doctrine was reported to have said that "China has claimed Natuna waters as their territorial waters. This arbitrary claim will have large impact on the security of Natuna waters." (Adopted from Leo Suryadinata, "South China Sea: is Jakarta no longer neutral?", *The Strait Times*, 24 April 2014.)

⁵⁷ Ann Marie Murphy, "Jakarta rejects China's nine-dash line", *AsiaTimes online*, 3 April 2014.

Islands and transferred the Chinese crew to its boat to be taken ashore. Before reaching land, Chinese armed vessels confronted the Indonesian boat, and demanded the release of the Chinese fisherman.⁵⁸

Thus, although Indonesia has reservations over external powers' role in the regional security, it has changed this attitude, supporting the deployment of US marines in northern Australia. Indonesian Foreign Minister Marty Natelagawa rejected China's view that the US should not become involved in the South China Sea dispute.⁵⁹ Nevertheless, Indonesia's support for US's involvement is limited, and it is unwilling to see external powers deploy too many military forces in the region, as Indonesia's ambition is to become the leader of the region.⁶⁰

Malaysia and Brunei

Malaysia and Brunei, the other two claimant states, have studiously adopted a low public profile over the dispute. Malaysia believes that "China is a country you can expect to be friendly and trust"⁶¹ and is willing to solve the problem through bilateral diplomacy, supporting China's proposition that the South China Sea issue should not be internationalized.⁶² China also holds that "China and Malaysia are sincere friends who trust and support each other, and are reliable partners who cooperate equally and mutually beneficial".⁶³ This was reflected by the

⁵⁸ Ibid.

⁵⁹ "Indonesia seeks for road for South China Sea", *South China Morning Post*, 26 September 2012.

⁶⁰ 王森, 杨光海, "东盟'大国外交'在南海问题上的运用" (Implementation of ASEAN's big power diplomacy in South China Sea issue), *Journal of Contemporary Asia-Pacific Studies*, No.1 2014, pp.35-57.

⁶¹ "重叠问题: 中国被呼吁应更加慎重" (Overlapping issue: China was called to be more cautious), *Herald* (Malaysia), 16 June 2011.

⁶² Liselotte Odgaard, "The South China Sea: ASEAN's Security Concerns About China", *Security Dialogue*, Vol.34, No.1, March 2003.

⁶³ Chinese Premier Wen Jiabao's speech at the China-Malaysia Trade and Investment Cooperation Forum, 29 April 2011, <<http://news.sina.com.cn/c/2011-04-29/020622377866.shtml>>.

realities that Chinese fishing boats can regularly go into Malaysia's EEZ without confrontation, and Chinese paramilitary vessels regularly watch vessels operated by Petronas, the state oil company, servicing off-shore rigs in Malaysia's EEZ.

In 2013 and January 2014, a People's Liberation Army Navy (PLAN) flotilla travelled to James Shoal, 80 kilometers off the coast of East Malaysia and the southernmost point of China's nine-dash line claim to the South China Sea. The chief of Malaysian Armed Forces confirmed that the Chinese flotilla had been monitored as it "strayed into Malaysian waters. As long as it was an innocent passage, that is okay with us." Malaysian officials privately stated that the "see nothing, know nothing" stance is dictated by Prime Minister Najib Razak who controls South China Sea policy.⁶⁴ Malaysian officials are aware of Chinese fishing activities and other assertions of Chinese sovereignty in the EEZ. In 2013, for example, Malaysian diplomats privately briefed academics from an ASEAN think tank and told them that aerial photos confirmed that the PLAN flotilla was near James Shoal.⁶⁵

Nevertheless, Malaysia is also concerned that bilateral negotiations have not been conducive to Malaysia and ASEAN. Therefore, although Malaysia tends to resolve the border dispute through bilateral consultation and cooperation, it prominently emphasizes the integrity of ASEAN, promoting the discussion of the South China Sea issue through multilateral talks and forums, and developing multilateral relations with countries outside the region. In June 2011 at the 10th Shangri-La Dialogue meeting held in Singapore, Malaysian Prime Minister Najib pointed out that "China is our (ASEAN) partner, the US is as well. I want to explain to our friends from the US, China, Russia, India as well as other regions that in ASEAN, we have common values and aspirations. We invite you to have positive cooperation with us. For the future, we need multilateral relations rather than bilateral relations to replace the

⁶⁴ Carlyle A. Thayer, "Can ASEAN respond to the Chinese challenge", YaleGlobal Online, 18 March 2014, <<http://yaleglobal.yale.edu/content/can-asean-respond-chinese-challenge>> [access on 14 May 2014]

⁶⁵ Ibid.

bilateral relations during the Cold War.”⁶⁶ The Malaysian government also responded positively to the US’s South China Sea policy, expressing its understanding of US military forces stationed in the South China Sea.⁶⁷

Chinese perceptions

Although ASEAN countries remain uncertain about China’s long-term intentions in the region, they realize that the economic importance of China has grown, while worrying that US trade and economic policy is ideological and inconsistent with its geostrategic objectives.⁶⁸ As a consequence of China’s economic rise and diplomatic assertiveness, most ASEAN countries have China as their major trading partner and foreign investor while they depend on the US for the maintenance of the regional security order. This strategic “dual dependency” on the US and China has led to the strategic ambivalence in ASEAN as a regional organization and as individual countries. This has affected their economic cooperation with China to a significant extent.

Take the Philippines for example. Throughout most of the 1980s, the Philippines was beset by political instability and economic malaise, and was in dispute with China over the South China Sea. It was, therefore, not in a position to take advantage of China’s economic liberalization. The country fell behind most of its ASEAN neighbors, whose trade and investment ties with China expanded remarkably during the period. The situation did not change until 2000 when former Philippine President

⁶⁶ “马来西亚专注全球安全” (Malaysia focuses on global security), *Herald* (Malaysia), 4 June 2011.

⁶⁷ 王森, 杨光海, “东盟‘大国外交’在南海问题上的运用” (Implementation of ASEAN’s big power diplomacy in South China Sea issue), *Journal of Contemporary Asia-Pacific Studies*, No.1 2014, pp.35-57.

⁶⁸ For instance, instead of engaging ASEAN and other important Asian markets, either individually or through attempting to join ASEAN-centred RCEP – the preferred economic engagement vehicle for most of the East Asian countries – the U.S. has focused on the TPP, which involves only 4 of 10 ASEAN countries and for which only 7 of 10 are eligible.

Estrada visited China and signed a joint declaration on the Framework of Bilateral Cooperation in the 21st Century. Since then, China-Philippine bilateral trade has risen rapidly. In 2003-2011, this increased steadily from US\$9.4 billion to US\$32.3 billion, a rise of 244 percent, making China the Philippines' third largest trading partner after the US and Japan.⁶⁹

However, most Filipinos tend to judge Chinese foreign policy on the single issue of how it handles its dispute with the Philippines in the South China Sea, although China's foreign policy goals and interests have a much wider reach.⁷⁰ Thus, although economic ties have continued to improve, the degree of wariness towards this major power has increased as the tension in the South China Sea heightened, and the fears have extended to economic areas. In the Philippines, there was great fear that the asymmetrical economic interdependence between these two countries could spell trouble for the Philippine economy. The Philippines still has distrust and uneasiness about Chinese investment, and has yet to jump completely onto the Chinese economic bandwagon. In the Philippine perspective, "Beijing's main motive for developing economic relations with the Philippines is to wean it away from Washington, while isolating the U.S. politically and diplomatically to the maximum possible extent".⁷¹

Thus, in contrast to other ASEAN countries, the Philippines has not been very active in negotiating FTAs with China and other countries. Manila did not have clear strategies or policies on the ASEAN-China FTA and has largely been a follower of the trade negotiations in ASEAN.⁷² Consequently, compared with other Southeast Asian countries, the growth in Philippine trade with China has been much slower in recent years.

⁶⁹ China's Customs Statistics Yearbook, 2011.

⁷⁰ Aileen San Pablo-Baviera, "The Philippines in China's soft power strategy", *ISEAS perspective*, 3 June 2013.

⁷¹ Renato Cruz De Castro, "Balancing Gambits in Twenty-First Century Philippine Foreign Policy Gains and Possible Demise?", *Southeast Asian Affairs* 2011, p. 240.

⁷² Jose L. Tongzon, "Trade Policy in the Philippines: Treading a Cautious Path", *ASEAN Economic Bulletin*, VL 22, no.1, 2005.

For example, in 2013, Philippine trade with China was lowest among ASEAN-5, only about one third that of Malaysia's trade with China. The tactical decision made in late 2013 to revise Manila's strategy towards Beijing has been evident in President Aquino's repeated calls for direct talks with the Chinese leadership. Indeed, how to deal with the opportunities and challenges posed by a rising China is the key policy issue faced by the Philippine government. After all, even the US has realized that it must make use of China's capital and funds to help maintain its huge deficit and strategic ambition. As stated in Ian Bremmer's cover story for *The National Interest*: "In 1977, China accounted for just 0.6 percent of global trade, and in 2012, it became the world's largest trading nation. Today, 124 countries count China as their largest trade partner, compared to just 76 for the U.S."⁷³ The Philippines may in the near future find it difficult not to adjust its relationship with China.

The impact of the South China Sea dispute on China-Vietnam economic ties may be reflected differently. Compared with the Philippines, the dynamics of economic relations between Vietnam and China are rather different. Hanoi's strategies are shaped by its history, economy and geographical proximity with China. Hence it holds a more positive attitude to economic cooperation with China, and is more willing to separate territorial disputes from economic issues. In Vietnam, Chinese FDI increased from US\$189.2 million in 2011 to US\$350 million in 2012, with the cumulative amount being US\$1.6 billion. In fact, as a large proportion of Vietnam's FDI inflows originate from Hong Kong and the British Virgin Islands, a considerable proportion of Chinese FDI in Vietnam was realized through these places.

In Vietnam, China started with the labour-intensive manufacturing industries, which largely targeted the global export markets. Chinese investment in Vietnam covers a variety of fields, spreading over a range of industries from garment and electronics to motorcycle manufacture.

⁷³ Quoted from Hamza Mannan, "Kerry missing the boat on Asia", *Asia Times Online*, 14 January 2014.

Obviously, Vietnam has a comparative advantage in labour forces, and mineral and agricultural sources; while China has a comparative advantage in industrial products, capital and technology. These economic complementarities show that there is substantial intra-industry trade made by multi-national companies. Besides this, China exports capital goods and industrial intermediate products to Vietnam to exploit cheap labour and raw materials there, while Vietnam exports finished products to the US and EU. The US is actually the largest export market for Vietnam. From 2005 to 2011, Vietnam's exports to the US increased nearly twice, from US\$5.9 billion to US\$17 billion, according to IMF figures. The EU is the second largest export market for Vietnam. From 2005 to 2011, Vietnam's exports to EU increased over two times, from US\$4.1 billion to US\$12.6 billion.⁷⁴ This suggests that the labour division based on comparative advantages between China and Vietnam has made both sides closely linked within the international production network, and forms an important part of the global supply chain. In this sense, any disruption to China-Vietnam bilateral economic ties caused by disputes may not only affect Vietnam's industrialization process, but also threaten Asia Pacific trade and the global production chain.

CONCLUSION: LOOKING AHEAD

While it is accepted that energy resource competition and territorial disputes in the South China Sea can lead to conflict and harm China-ASEAN relations, the role that natural resource cooperation plays in ensuring regional stability and peace-making should not be ignored. The fact that China has emerged as an increasingly large regional investor and energy resources consumer, and the emphasis it puts on getting as much of its future oil and gas from as close to home as possible, are increasing its interest in developing energy resources in the South China Sea. ASEAN countries, at the same time, are also turning to cleaner-burning gas to generate electricity and create a clean environment.

⁷⁴ IMF, Direction of Trade Statistics, Yearbook 2012.

Thus energy resource rivalry may also create cooperation opportunities. “Joint development” is nevertheless the best option for related claim countries.

Given possible conflicts in the oil and gas rich South China Sea, China and Southeast Asian countries need to further strengthen strategic trust and forge a security partnership in general and maritime cooperation more specially. In November 2002, China and ASEAN signed the DOC. The following year, the Chinese and Philippine national oil companies signed a letter of intent to jointly develop petroleum extraction. In 2005, China, the Philippines and Vietnam signed a tripartite agreement on joint seismic surveying activities in the South China Sea. In 2006, PetroVietnam and CNOOC signed a memorandum of understanding on exploration and production in the disputed area, and the geographic area covered by the agreement was expanded in the summer of 2013. Actually, China’s ambiguous definition of the nine-dash line and its “strategic uncertainty” has allowed all countries involved or interested in South China Sea disputes to maintain a certain status quo, renouncing none of their respective claims while avoiding direct military confrontation.⁷⁵ Clearly, under the Xi Jinping administration, Beijing’s strategy in the South China Sea issue is considered crucial to its ASEAN policy, driving it to seek more flexible and efficient measures. This is reflected in the releases from an October 2013 work conference on peripheral diplomacy which emphasized the importance of greater coherence in China’s overall foreign policy toward its periphery, treating regional neighbors as friends and partners to make them feel safe and help them develop and fostering a sense of common destiny between China and its neighbors.⁷⁶ All this indicates that “while predicting future Chinese actions is difficult, it would seem that China is willing to modify

⁷⁵ Interview in Xiamen University, 30 July 2014.

⁷⁶ “Xi Jinping: Let the sense of community of common destiny take deep root in neighboring countries,” Ministry of Foreign Affairs of the People’s Republic of China, 25 October 2013, <http://www.fmprc.gov.cn/mfa_eng/wjb_663304/wjbz_663308/activities_663312/t1093870.shtml>.

its historic claims in return for increased access to indigenous energy reserves”.⁷⁷

The prerequisite for China-ASEAN energy development cooperation in the South China Sea is mutual trust and understanding. While China insists on “shelving the disputes (of sovereignty) and working for joint development”, for some ASEAN countries, concerns over national security, territorial integrity, and control of maritime resources outweigh the considerations of joint development. For example, Manila insists that Chinese participation in related projects should be in accordance with the Philippine Constitution, with recognition of the area as belonging inside the Philippines’ EEZ, and subject to the laws of the Philippines.⁷⁸ This is the main obstacle to joint development. China and relevant ASEAN countries can take steps to build confidence that their maritime activities, including fishing, investigative and surveillance operations, and military training, will not intentionally provoke the other side. Through cooperation, individual countries would regard the energy potential in the South China Sea from a wider regional perspective, rather than being restricted to effects from an individual or a nationalist viewpoint. From a security point of view, the advancement of mechanisms to develop resources jointly in disputed waters would create norms for subsequent territorial settlements. Cooperation between states and civil societies to reduce energy-related pollution and the emission of carbon dioxide would help facilitate exchanges, leading to greater regional cooperation.

Assuming that all sides are able to settle or shelve their competing territorial claims, the South China Sea is ripe for accelerated development. Since China is a natural market for the hydrocarbons that may be produced, energy resource cooperation can become a cementing factor for stability and peace making rather than an undermining factor in China-ASEAN relations.

⁷⁷ Zhao Suisheng, “China’s global search for energy security: cooperation and competition in the Asia-Pacific. Zhao Suisheng, “China’s global search for energy security: cooperation and competition in the Asia-Pacific”, *Journal of Contemporary China*, issue 55, 2008, pp. 207-27.

⁷⁸ Christopher Len, “Reed Bank: next flashpoint for China and the Philippines in the South China Sea?”, *Policy Brief* (Institute for Security & Development Policy), No.153, 26 May 2014.

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