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**NATIONAL DEFENSE UNIVERSITY**

**JOINT FORCES STAFF COLLEGE**

**JOINT ADVANCED WARFIGHTING SCHOOL**



**COUNTERING CHINA'S ECONOMIC STATECRAFT IN THE SOUTH CHINA SEA**

by

Bradford D. Wallace

*Commander, United States Navy*

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Countering China's Economic Statecraft in the South China Sea

By

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Commander, United States Navy

A paper submitted to the Faculty of the Joint Advanced Warfighting School in partial satisfaction of the requirements of a Master of Science Degree in Joint Campaign Planning and Strategy. The contents of this paper reflect my own personal views and are not necessarily endorsed by the Joint Forces Staff College or the Department of Defense. This paper is entirely my own work except as documented in footnotes.

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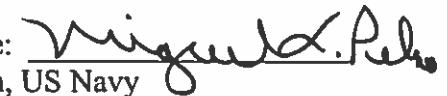
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## **Abstract**

The United States assesses the South China Sea and the Straits of Malacca as vitally important to the world economy due to their location and the amount of trade that passes through the two bodies of water each year. China also believes its security and prosperity is tied to these two bodies of water. As China's power and stature in the international community has grown over the last thirty-years, it has asserted that the South China Sea is a priority issue, and created and employed a vision and strategy to control it. China continually demonstrates its economic might in the region and conducts economic statecraft to influence policy in the region. The US needs to create a policy and long-term strategy that brings to bear all the national instruments of power to counter China's rising influence in the South China Sea. The policy and strategy should incorporate establishing strong economic ties in the region, creating a South China Sea Code of Conduct, further cultivating the US-India relationship, and using lawfare to counter China. The US needs to ensure that it is ready to employ its strategy and be poised and prepared to counter the rise of China to remain relevant in the region.

## **Dedication**

To my wonderful wife and unbelievable children,

I want to thank you for your support through this exhaustive endeavor. I hope that the final product is something that you can all be proud of because without your encouragement I could not have written this thesis.



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## Chapter I: Introduction

*“For whosoever commands the sea commands the trade, whosoever commands the trade of the world commands the riches of the world, and consequently the world itself”*  
- Sir Walter Raleigh<sup>1</sup>

The location of the South China Sea (SCS) makes it one of the most important and contested bodies of water on the planet. The SCS lies to the east of the Straits of



Malacca, which connect the Pacific Ocean to the Indian Ocean. The Straits of Malacca represent the second busiest maritime choke point in the world and between \$3.4 to \$5 Trillion of trade sailed through the South China Sea and Straits of Malacca in 2016.<sup>2</sup> Due to the amount of trade that passes through those two bodies of

water each year, the United States assesses the SCS and the Straits of Malacca as vitally important to the world economy.

The seven nations that surround the SCS all rely on it for their economic wellbeing as well as their security. Brunei, China, Indonesia, Malaysia, Philippines, and

<sup>1</sup> Walter Raleigh, “A Discourse of the Invention of Ships, Anchors, Compass, &c.”, in *The Works of Sir Walter Raleigh, Kt., Vol. VIII: Miscellaneous Works* (Oxford Univ. Press, 1829), p. 325.

<sup>2</sup> China Power Team, “How much trade transits the South China Sea?,” China Power, <https://chinapower.csis.org/much-trade-transits-south-china-sea/> (accessed September 11, 2017).

Vietnam each claim parts of the SCS. China's interest in the SCS intensified as its economic and military might slowly increased over the last thirty years. In 2009, China formally claimed a nine-dashed line that encompasses most of the SCS. China claims exclusive rights to all that lies within its nine-dashed line including the sea, islands, reefs, shoals, ocean floor and resources under the ocean floor. The nine-dashed line would lock out all the other claimants from the ability to cultivate these resources for economic gain.

The SCS by virtue of its location makes it potentially the most contested body of water in the world. The countries that border it rely on it for their economy and security. Moreover, the US and its regional partners and allies rely on it for their economy and security. China has been emboldened to take a more aggressive approach in its foreign policy, as well as to modernize its military. In addition, China began an artificial island building campaign by "reclaiming" nearly 3,000 acres of land in the Spratly island chain on Mischief Reef and Fiery Cross Reef and other shoals in the SCS. Beyond creating islands through land reclamation, it has militarized these newly formed islands.

### **Concerns and Thesis**

Many difficulties exist when trying to determine China's intentions and strategy in the SCS and the impact that they have on the US and its regional allies and partners. The intentions become more difficult to assess when attempting to determine where the SCS fits in with China's overall grand strategy. Many different questions emerge on the SCS topic regarding China and the other claimants. What goals does China want to accomplish with its island building campaign? Can the US, its regional allies and partners, and China find a middle ground where all sides are satisfied? What pressure

points can other nations apply that might influence China's decision-making? What pressures can the US apply to counter China's island building campaign in the SCS? What instruments can the US apply to ensure stability in the region? Answering these questions will shape how the US can improve its policy toward China and the SCS.

China's militarization of its manmade islands and the modernization of maritime forces by other states that border the SCS make this region potentially volatile due to overlapping sovereignty claims. Arguably, the SCS has already become an active battleground for all of these countries. Many of these countries have modernized their militaries in order to defend their claims to the SCS. For these reasons, the SCS region presents a unique challenge to US foreign policy makers and US Pacific Command (USPACOM).

Therein lies the crux of the US problem. Many problems and questions abound, but there is no concrete US policy regarding the SCS that takes into account the militarization of the islands in the SCS. The US needs to develop a strategy quickly to counter the Chinese, because waiting only strengthens the Chinese position. In an effort to counter Chinese economic statecraft in support of its nine-dashed line policy in the South China Sea, the US must take a more assertive posture toward China by supporting regional allies and partners and applying regional pressure through a combination of military, economic, political, and legal levers.

## **Chapter II: Organization and Methodology**

This thesis represents a qualitative analysis to first provide an overview of the SCS region and its importance. The research draws most of the information from scholarly articles, books, and think tanks. This thesis will analyze the importance that China's leadership places on the SCS. It will further discuss the role the SCS plays in China's economic resurgence and strategy. It will also discuss the different countries that have asserted claims to the waters, islands, reefs, shoals, ocean floor and resources under the ocean floor located there. The examination will briefly discuss the security challenges that are developing from the modernization of these other countries' military forces resulting from the threats posed by China in the SCS. Additionally, the analysis it will evaluate different case studies where China recently applied economic leverage on nations to achieve political goals. Finally, this paper will discuss possible methods the US can use to counter Chinese economic tactics in order to decrease China's grip on the SCS, bolster the other five countries' positions and claims to the contested waters, and maintain the status of the SCS waters under international law.

## Chapter III. Chinese Leadership and Strategy

### President Xi Jinping

President Xi Jinping recently won his second term as the President of China during the 19<sup>th</sup> Communist Party of China National Congress. The inclusion of his name and ideology into the guiding principles for the Party demonstrates that his viewpoint and rhetoric shape Chinese policy. Additionally, adding President Xi Jinping to the PRC Constitution, a first for a living president since Chairman Mao, illustrates that his power and thinking shape China more than any other leader since Mao. Xi follows the principle that Singapore's former Prime Minister Lee Kuan Yew espoused regarding a nation's successful leader, "[He must] paint his vision of their future to his people, translate that vision into policies which he must convince the people are worth supporting, and finally galvanize them to help him in their implementation."<sup>1</sup>

Xi understands that in order to place China back at the forefront of world politics, demanding and aggressive policies will need to be instituted. Through his policies and the increase of China's prestige, Chinese pride and nationalism will return. The Chinese government uses all instruments of its national power to bolster its position in world opinion and demonstrate China's economic strength. An example of China employing its economic strength domestically took place during the global financial crisis. One of Xi's economic advisors, Liu He, describes the aggressive policies and projects China implemented compared to US economic tools it exercised during the global financial crisis. Liu boasts how the Chinese government introduced a \$586 billion stimulus

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<sup>1</sup> Graham Allison, *Destined for War: Can America and China Escape Thucydides's Trap?*, 116.

package creating a network of fast trains moving its citizens between its major cities economically. During this time, the US spent \$983 billion in its financial stimulus package and has no concrete achievements to show for it.<sup>2</sup> Xi created a vision for his people and government using economic policies and tools to improve the infrastructure as a means of successfully dealing with the financial crisis. Xi believes he can and will lead China to greatness, and will not hesitate to use all elements of Chinese national power to achieve his goals.

### **China's Economic Growth**

China's economic growth is intrinsically tied to the Straits of Malacca and the SCS. China's import/export economy maintains an over reliance on the Straits of Malacca and the SCS. Seventy to eighty percent of the total shipping that transits between these two bodies of water either starts in China or ends in China.<sup>3</sup> Beyond the economic benefits created through the shipping industry, the SCS provides energy resources and robust fishing opportunities to strengthen those financial sectors within China.

China looks to the SCS and the Straits of Malacca for its survival. China recognized the importance of the two bodies of water and created a policy to protect its interests. It begins with the declaration of the nine-dashed line and includes the artificial island building campaign. Through these two initiatives, China demonstrates its resolve to control the SCS as a means to increase its regional security and increase its prosperity. Though the Chinese government is not inherently transparent, these activities and the

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<sup>2</sup> Graham Allison, *Destined for War: Can America and China Escape Thucydides's Trap?*, 118.

<sup>3</sup> Alba Iulia Papescu, *Control of Key Maritime Straits – China's Global Strategic Objective*, 3.



comments made by President Xi Jinping reveal insights into the vision and strategy driving the Chinese SCS policy. President Xi stated:

“In the 21<sup>st</sup> century, mankind has entered the age of the large-scale exploitation of the sea. . . . The sea has played a more prominent role in the preservation of state sovereignty, security, and the rewards of development. . . . History and experience tell us that a country will rise if it commands the oceans well and will fall if it surrenders them. A powerful state possess durable sea rights, and a weak state has vulnerable sea rights. . . . Whether we are able to solve successfully problems of the oceans is related to the existence and development of our nation, the rise or fall of our country. . . . We must adhere to a development path of becoming a rich and powerful state by making use of the sea.”<sup>4</sup>

President Xi also stated:

“[O]ur country’s adjacent sea areas, especially the South China Sea, are the regions of the world where most territorial disputes concerning island sovereignty exist, the issues of delimitation of the sea areas appear the most unyielding, the competition for resources is the most intense, and the geopolitical situation is the most complex. . . . [W]e should make full preparation for handling such complex situations by accelerating construction of a modernized navy, enhancing the capability to ensure our maritime rights, and resolutely acting to guard those maritime rights and interests.”<sup>5</sup>

Obviously, President Xi views maritime power and control of the SCS as a prerequisite to becoming a world power. His comments also provide insight on what happens when a state “surrenders” its control of the seas. Furthermore, comments from President Xi illustrate that competition among the regional claimants in the SCS is very real. The contested waters resulting from the overlapping sovereignty claims could lead to complex situations. Complex situations might mean something as simple disputed fishing rights that can be solved diplomatically. However, extrapolating his comments

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<sup>4</sup> John W. Lewis and Xue Litai, “China’s Security Agenda Transcends the South China Sea,” *Bulletin of The Atomic Scientists* Vol. 72, No. 4 (July 2016): 216.

<sup>5</sup> John W. Lewis and Xue Litai, “China’s Security Agenda Transcends the South China Sea,” 216.

for a strong and modern navy could mean a limited naval conflict might be required to gain command of the sea and secure “maritime rights.”

President Xi also understands that to get China where he wants it to go will require it overtaking US influence in the region. By “accelerating construction of a modernized navy,” China can shape a perception of strength while depicting a perceived decline of US naval power in the region. These comments, the modernization of the Chinese Navy, and the island building campaign demonstrate that President Xi has more than just a vision, he has a policy and a strategy to accomplish his goal of becoming a world power and the hegemonic power in Asia.

### **China’s Strategy**

Various official strategy documents produced and disseminated for public consumption reflect President Xi’s comments. In China’s 2015 Military Strategy, it declared:

The seas and oceans bear on the enduring peace, lasting stability and sustainable development of China. The traditional mentality that land outweighs sea must be abandoned, and great importance has to be attached to managing the seas and oceans and protecting maritime rights and interests. It is necessary for China to develop a modern maritime military force structure commensurate with its national security and development interests, safeguard its national sovereignty and maritime rights and interests, protect the security of strategic SLOCs and overseas interests, and participate in international maritime cooperation, so as to provide strategic support for building itself into a maritime power.<sup>6</sup>

President Xi knows that the strategic location of these artificial islands protects the SLOCs and safeguards China’s nine-dashed line claims. Therefore, the Chinese

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<sup>6</sup> People’s Republic of China, State Council Information Office. “China’s Military Strategy.” (May 2015) <http://news.usni.org/2015/05/26/document-chinas-military-strategy>.

leadership will not allow anyone or any organization to stop his island building campaign and the militarization of those artificial islands in the SCS. The Permanent Court of Arbitration in The Hague ruled against China when the Philippines conducted an International Tribunal using the United Nations Convention of the Law of the Sea (UNCLOS) as a basis to counter China's extensive claims in the SCS in July 2016. The landmark ruling failed to elicit any type of effective response to stop China's island building and militarization campaign.<sup>7</sup> China's blatant disregard for the UNCLOS demonstrates that it will not be deterred by international organizations or international law. It begs the question, "What will get China's attention?"

China's island building and militarization campaign in the SCS creates a myriad of problems, the most significant of them being that the commons in the vicinity of the Straits of Malacca could be held at risk. As a result, the US economy and ability to provide security to our regional allies could be affected. Furthermore, the tenuous relationship with an aggressive China complicates any decisions regarding this region.

### **Other SCS Claimants' Military Expansion**

Besides China being reliant on the SCS and the Straits of Malacca, Brunei, Indonesia, Malaysia, the Philippines, Singapore and Vietnam also rely heavily on the SCS and the straits for their economies. Their economic survival hinges on the natural resources located in the region and they feel threatened by China's growing military strength and the militarization of the artificial islands that China has built. Each of these

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<sup>7</sup> Ely Ratner, Course Correction: How to Stop China's Maritime Advance, Foreign Affairs, New York July/Aug 2017, 64-72. <https://www.foreignaffairs.com/articles/2017-06-13/course-correction> (accessed October 6, 2017).

countries belong to the Association of South East Asian Nations (ASEAN) and rely on that treaty to provide a level of collective cooperation to counter the threat of larger countries' influence on the individual smaller countries. However, as politically important as ASEAN is in the region, ASEAN has no collective security arrangement with its members. Because of the escalating threat from China, many of these countries increased their military spending to improve security.

Many of these countries improved their security through the development of maritime assets in an effort to provide a level of defense against China. Vietnam contracted and purchased from Russia six *Kilo*-class submarines.<sup>8</sup> Vietnam launched the first submarine in August 2012. Malaysia recently upgraded its submarine fleet with the purchase of two new submarines equipped with the Air-Independent Propulsion (AIP) technology.<sup>9</sup> These countries are modernizing their maritime forces through the purchase of submarines but are also looking at surface vessels as well. Vietnam recently purchased the *Gepard*-class frigates from Russia to protect their exclusive economic zone (EEZ) and the Philippines modernized its fleet with the donation of two former US coast-guard cutters.<sup>10</sup>

Indonesia understands the need to maintain a capable navy to defend its territorial claims. In 2016, Indonesia and China clashed three times in SCS waters claimed by both Indonesia and China. All three maritime skirmishes occurred within Indonesia's 200-

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<sup>8</sup> Sarah Raine and Christian Le Miere, *Regional Disorder: The South China Sea Disputes*, Abingdon, Oxon: Routledge, 2013, 133.

<sup>9</sup> Sarah Raine and Christian Le Miere, *Regional Disorder: The South China Sea Disputes*, Abingdon, Oxon: Routledge, 2013, 134.

<sup>10</sup> Sarah Raine and Christian Le Miere, *Regional Disorder: The South China Sea Disputes*, Abingdon, Oxon: Routledge, 2013, 135.

nautical-mile exclusive economic zone around the Natuna Islands<sup>11</sup>. Indonesia and China know that the North Natuna Sea maintains abundant oil and natural gas reserves as well as rich fishing grounds. In an effort to solidify its claims to the waters surrounding Natuna Islands, Indonesia recently renamed the waters around the islands to the North Natuna Sea. President Joko Widodo, Indonesia's president, has made it a priority to improve its maritime capabilities. Recently, it expanded its naval port facilities in Natuna and extended the runway at its air force base. These new facilities will allow for larger ships and larger aircraft. Indonesia worked with Singapore and the Philippines to negotiate maritime boundaries. Following the negotiations, Indonesia released a new map in July of 2017 showing the maritime boundaries to include the newly named North Natuna Sea.<sup>12</sup>

All of these countries surrounding and asserting claims in the SCS are improving their maritime capabilities to be prepared to defend their claims. These countries know that China will continue to apply incremental power grabs in the region and rely on its nine-dash line policy to defend the claims. These countries fear that China will only respect a strong, forceful response to counter China's asserted claims in the SCS. The fact that Indonesia and China have already engaged in skirmishes demonstrates how volatile the SCS has already become.

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<sup>11</sup> Joe Cochrane, "Indonesia, Long on Sidelines, Starts to Confront China's Territorial Claims," *New York Times*, September 10, 2017. <https://www.nytimes.com/2017/09/10/world/asia/indonesia-south-china-sea-military-buildup.html> (accessed February 13, 2018).

<sup>12</sup> Joe Cochrane, "Indonesia, Long on Sidelines, Starts to Confront China's Territorial Claims," *New York Times*, September 10, 2017. <https://www.nytimes.com/2017/09/10/world/asia/indonesia-south-china-sea-military-buildup.html> (accessed February 13, 2018).

## Chapter IV. China's Economy

### China's Economic Influence on Military Modernization

Xi is painting his version of the China Dream that includes, "Reorganizing and rebuilding China's military so that it can 'fight and win.'"<sup>1</sup> China's economy plays a critical role in its national security and force modernization. The economy pays for the expanding military strength that provides the most tangible form of national security. The Center for Strategic and International Studies (CSIS) discusses the influence of the economy to China's global prestige and power and its relationship to military modernization in a recent assessment on China. CSIS proposes, "China's role as a major trading partner and exporter may ultimately give it more influence and leverage in dealing with the US and the world than the modernization of its military forces and increases in power projection capability."<sup>2</sup> Due to the importance of the economy to China's national security, understanding the strengths and the weaknesses of it provides a peer nation the ability to create a strategy to counter its strengths and manipulate its weaknesses to gain an advantage.

The strength of China's economy influences its decision-making as well as its stature in the international community. CSIS states, "China's economic growth has supported the changes in its strategy and force structure, as well as its rapid rate of military modernization. At the same time, China's high rate of economic growth, the size of its gross domestic product (GDP), and its large population have made it a major force

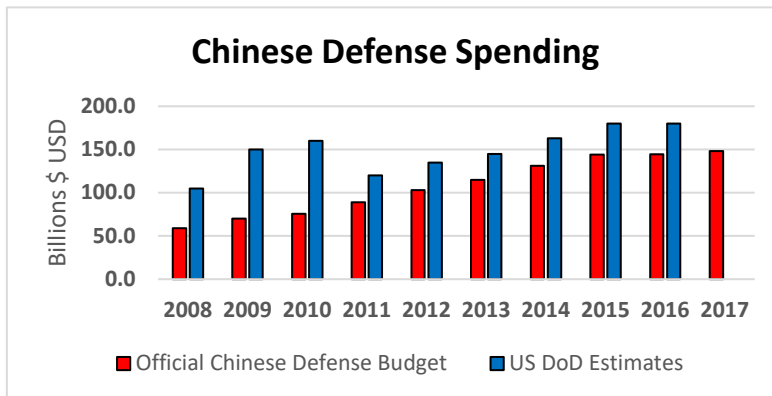
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<sup>1</sup> Graham Allison, *Destined for War: Can America and China Escape Thucydides's Trap?*, 117.

<sup>2</sup> Anthony F. Cordesman, and Joseph Kendall, *Chinese Strategy and Military Modernization in 2017: A Comparative Analysis*, Washington: CSIS/New York: Rowman & Littlefield 2017, 57.

in the global economy.”<sup>3</sup> There is no question that the unparalleled growth of the economy provides the driving force to modernization of the military.

China’s military benefits from the tremendous strength of its economy. China over the last decade and a half displayed unprecedented investment in its military. The US Department of Defense (DoD) evaluates China’s military expenditures annually and



highlights the remarkable increase in investment. In May 2017, the US DoD issued its annual report on Chinese military power. The report highlighted that

China increased its annual military budget by 7 percent to \$144.3 billion USD.<sup>4</sup> This increase in the military budget coincides with an average 8.5 percent per year in inflation-adjusted increases that occurred from 2007 to 2016.<sup>5</sup> Though China stated that these are the official numbers, transparency has never been a trait that the Chinese Communist Party (CCP) is known for. As a result, the US estimates that in 2016 China spent over \$180 billion.<sup>6</sup>

The investment that China is making in its military creates concern and doubt in other nations in the region. The Japanese Defense Department released a white paper

<sup>3</sup> Cordesman, *Chinese Strategy and Military Power in 2017*, 57.

<sup>4</sup> U.S. Department of Defense, *Annual Report to Congress: Military and Security Developments Involving the People’s Republic of China 2017*, Office of the Secretary of Defense (Washington D.C., 15 May 2017), 65.

<sup>5</sup> U.S. DoD, *Annual Report to Congress: Military and Security Developments Involving the People’s Republic of China 2017*, 65.

<sup>6</sup> U.S. DoD, *Annual Report to Congress: Military and Security Developments Involving the People’s Republic of China 2017*, 66.

expressing their concerns with China's military growth. In its white paper Japan highlights that, "China has been sustaining large increases in its defense spending and broadly and rapidly reinforcing its military forces, mainly its nuclear and missile force as well as its Navy and Air Force."<sup>7</sup> Not only does Japan feel vulnerable by China's military growth, but others in the region share Japan's security concerns as well.

Ultimately, many countries question the reasons for the increase in expenditures. To what ends are the growth of the military directed? Similar to a boxer in the ring, does the military and strong economy represent a one-two punch that China will use on its regional neighbors when they do not acquiesce to China's desires? There is no doubt that China's large modern military enhances its ability to exercise economic statecraft to coerce other regional nations.

### **China's Economic Weaknesses**

Though China's economic growth makes it the fastest growing economy in the world over the last thirty years, its economy is not without growing problems. The Chinese economy is over-reliant on exports and as a result is heavily influenced by the strength of the global economy.<sup>8</sup> In 2015, a World Bank report stressed the risks to China's economy by stating, "Risks, both external and internal to the region, remain tilted to the downside... Although the probability is low, the risk of a hard landing in China remains. Since the region's economies are very open, they are vulnerable to trading partner slowdowns and large exchange rate shifts, including further U.S. dollar

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<sup>7</sup> Anthony F. Cordesman, Ashley Hess, and Nicholas S. Yarosh, *Chinese Strategy and Military Power in 2014: Chinese, Japanese, Korean, Taiwanese, and US Assessments*, Washington: CSIS/New York: Rowman & Littlefield 2014, 88.

<sup>8</sup> Cordesman, *Chinese Strategy and Military Power in 2014*, 77.



appreciation.”<sup>9</sup> In 2012, a World Bank report stressed the risks to China’s economy.

Regarding trade and finance, the report stated:

**Trade.** If the situation in Europe deteriorates sharply, global trade could fall by 5 or more percent with serious implications for the very open East Asia region.

**Finance.** The potential freezing up of international capital flows under emerging global conditions has increased, exposing East Asian countries, notably, China, Indonesia, Malaysia, and Thailand to the possibility of market disruptions, exchange rate volatility, and external financing pressures. Vulnerabilities are more acute for countries with large shares of short term and maturing debt or current account deficits.<sup>10</sup>

The concerns intensify, as the possibility of a global slowdown emerge resulting from the potential of a global correction in the major stock indexes of the world. The vulnerabilities to the economy not only affect trade and finance, but China is losing some industries to other countries in the region. As China’s economy continues to grow so does the standard of living for its population. Moreover, as the standard of living grows so too do the manufacturing and industrial wages that the workers receive increase. As a result, many industries are moving from China and looking to other countries with cheaper labor. Currently, Vietnam is one of the countries that benefits from the migration of industries out of China because Vietnam’s average wages are one-half of China’s wages for comparable work in the same industry.<sup>11</sup>

Foreign Direct Investment (FDI) demonstrates another potential soft spot in China’s economy. In 2012, China received over \$117 billion in FDI and between 2012-2015 planned to increase FDI to a four-year average of \$120 billion.<sup>12</sup> As recently as

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<sup>9</sup> Cordesman, *Chinese Strategy and Military Power in 2017*, 74.

<sup>10</sup> Cordesman, *Chinese Strategy and Military Power in 2014*, 77-78.

<sup>11</sup> Cordesman, *Chinese Strategy and Military Power in 2014*, 80.

<sup>12</sup> Cordesman, *Chinese Strategy and Military Power in 2017*, 95.

2012, the US increased its investment 4.5% to \$3.13 billion making it the fifth-largest investor in China. Japan, another close partner of the US, accounts for \$7.38 billion of investment. While both of these countries are in the top five of China's FDI, together they only make up roughly 9% of the foreign investment in China.<sup>13</sup> The FDI makes China susceptible to outside forces. Because of the close partnership the US has with Japan, together they might be able to apply pressure on the Chinese to achieve policy victories or leverage China's strategic decision-making.

### **One Belt, One Road Initiative**

China embarked on an unprecedented multitrillion-dollar infrastructure project in 2013, One Belt, One Road (OBOR). The OBOR project represents China's attempt to connect countries in Asia, Europe, and Africa using five different routes over land and sea. The OBOR refers to the land trade routes as the Silk Road Economic Belt (SREB) and the sea trade routes as the Maritime Silk Road Initiative (MSRI). Current plans stipulate that the SREB will use three routes linking China to Europe through Central Asia and Russia; connecting China with the Middle East through Central Asia; and bringing together China and Southeast Asia, South Asia and the Indian Ocean. The MSRI will focus on two transportation routes that will link China with Europe through the South China Sea and Indian Ocean, and connect China with the South Pacific Ocean through the South China Sea. Ultimately, the OBOR initiative will create six economic corridors: the China–Mongolia–Russia Economic Corridor, the New Eurasia Land

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<sup>13</sup> Cordesman, *Chinese Strategy and Military Power in 2017*, 95.

Bridge, China–Central Asia–West Asia Corridor, the China–Indochina Peninsula, the China–Pakistan Economic Corridor and the Bangladesh–China–India–Myanmar

Corridor.<sup>14</sup>

## China's One Belt, One Road



The railways, roads, and pipelines will traverse 1,800 miles and multiple countries in Asia and into Europe.<sup>15</sup>

The infrastructure projects will employ Chinese workers and will

provide Chinese steel and concrete industries an outlet to prop up economic stimulation.

The infrastructure projects also include the construction of multiple deep-water port facilities in Myanmar, Australia, Djibouti, and other coastal countries. Though the OBOR project is already underway in many of these countries, it will take decades to complete. Analysts forecast the economic benefits will help sustain the consistently high growth rate of China's economy. However, the economy is only a small portion of the benefit.

China advertises the OBOR initiative as a project that economically benefits all countries involved. However, China will benefit the most. OBOR will allow China to

<sup>14</sup> Xin Zhang, "Chinese Capitalism and the Maritime Silk Road: A World-Systems Perspective," *Geopolitics* Vol. 22, No. 2, (February 2017): 320. <https://doi.org/10.1080/14650045.2017.1289371> (accessed on 19 December 2017).

<sup>15</sup> Graham Allison, *Destined for War: Can America and China Escape Thucydides's Trap?*: Boston: Houghton Mifflin Harcourt, 2017, 125.

plug into these countries' economies like never before. Besides the Sinification that will occur when China exports their workforce to build these projects, China will wield more influence politically and economically as the economies of each country grow more dependent on China's economy. The OBOR could potentially represent the apex of Chinese economic statecraft as the project comes to fruition. Beyond the economic boon from the OBOR project, Chinese prestige might be the biggest benefactor of the project. Through OBOR, China will project power across multiple continents.<sup>16</sup> The geostrategic balance of power will shift toward China. China's sphere of influence will increase to new heights, ensuring that China will no longer be considered a regional power, but will be a world power economically and politically.

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<sup>16</sup> Graham Allison, *Destined for War: Can America and China Escape Thucydides's Trap?*, 125.

## Chapter V. China's Application of Economic Levers / China's Economic Statecraft

### Rare Earth Elements

China not only benefits from the resources available in the South China Sea (SCS), but also benefits from the abundance of resources that exist on the mainland. China's rare earth elements (REE) represent a substantial natural resource industry. REE play a crucial role in the development of critical technological components in mobile telephones, computers, televisions, energy-efficient lighting, and wind energy.<sup>1</sup> In the 1980s, Chairman Deng Xiaoping understood the importance of the REE to the future of China's economy. He believed that REE would create an economic boon for China in the same way that oil created an economic boon for Saudi Arabia.<sup>2</sup> China recognized that it could dominate the world-wide REE mining and production industry and between 1990 and 2012 the Chinese took absolute control of the market. In 1990 the Chinese only controlled 27% of total global production, but by 2012 they commanded 97% of total global production.<sup>3</sup> In order to create this domination of the world market, China undercut other countries' REE mining industry. As a result, many countries' mines shut down for failure to be competitive in the industry. Furthermore, two of the largest economies became over reliant on cheap Chinese REE exports. By 2013, Japan became the top consumer of Chinese REE at 22.4% of exports by volume and the US at 21.8% of

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<sup>1</sup> Nabeel A Mancheri, "World Trade in Rare Earths, Chinese Export Restrictions, and Implications." *Resources Policy* 46, (2015), 262.

<sup>2</sup> Brigid Gavin, "China's Growing Conflict with the WTO: The Case of Export Restrictions on Rare Earth Resources," *Intereconomics/Review Of European Economic Policy* 48, no. 4 (2013): 255.

<sup>3</sup> Brigid Gavin, "China's Growing Conflict with the WTO: The Case of Export Restrictions on Rare Earth Resources," 255.

exports by volume.<sup>4</sup> From this position of dominance, China began to exert its economic levers on these and other countries.

In September 2010, a maritime situation developed between China and Japan in the East China Sea. A Japanese Coast Guard (JCG) ship while on patrol in the vicinity of the disputed Senkaku Islands noticed a high volume of Chinese trawlers conducting illegal fishing. The JCG ordered the boats to leave, but one trawler failed to follow the order. The Chinese trawler then collided with the JCG ship. Following the collision, the trawler began to flee. Eventually, the JCG caught up to the trawler and boarded the vessel to find a drunk captain with his crew. The JCG crew arrested the captain and his crew and brought them to Japan. After a week, Japan allowed the crew to return to China. However, Japan continued to incarcerate the captain and intended to prosecute him in domestic court.

China and Japan looked at the incident differently. Japan viewed the actions of the captain as a violation of domestic law because his trawler rammed the JCG ship. On the other hand, China viewed this incident as an international event that needed to be resolved diplomatically. China and Japan entered into an agreement in 2004 to resolve these type of maritime issues through other means, interpreted to mean not in the domestic court system. China demonstrated its displeasure with Japan by condemning Japan's actions and reiterating that the two countries immediately begin diplomatic meetings. China still hoped to resolve the matter diplomatically. After a week of political haggling, the trawler captain still remained incarcerated. This prompted the

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<sup>4</sup> Nabeel A Mancheri, "World Trade in Rare Earths, Chinese Export Restrictions, and Implications." *Resources Policy* 46, (2015), 265.

Chinese to break off talks with the Japanese, leading to elevated tensions between the two countries.

China desired to end put this incident to rest in its favor and opened its economic coercion playbook. Following the failure of the diplomatic talks the “Chinese ministry of foreign affairs (MFA) then declared the suspension of a bilateral dialogue on joint oil and gas development in the East China Sea.”<sup>5</sup> Now the stakes had truly risen between the two countries. China intended to raise the issue at the United Nations. The US suggested that it could help mediate any negotiations to resolve the situation. The US met with both Japan and China separately to find a palatable resolution to this escalating situation. By this time however, Japan had reevaluated the situation and determined it best to go ahead and release the trawler’s captain. On September 24, Japan announced the release of the captain, believing that this would end the political standoff.

Unfortunately, on September 22-23 China already opened its economic coercion playbook and announced that it would impose an embargo of the REE to Japan.<sup>6</sup> China insisted that the economic embargo on REE shipments to Japan had more to do with China protecting important natural resources needed for its manufacturing industry than the situation with the Chinese trawler captain. To support these claims, China pointed to its domestic requirement increasing from 10,000 to 92,000 metric tons of REE between

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<sup>5</sup> Michael Green, Kathleen Hicks, Zack Cooper, John Schaus, and Jake Douglas, “Counter-Coercion Series: Senkaku Islands Trawler Collision,” Asia Maritime Transparency Initiative, Center for Strategic and International Studies, May 18, 2017, <https://amti.csis.org/counter-co-trawler-collision/> (accessed on October 10, 2017).

<sup>6</sup> Michael Green, Kathleen Hicks, Zack Cooper, John Schaus, and Jake Douglas, “Counter-Coercion Series: Senkaku Islands Trawler Collision,” Asia Maritime Transparency Initiative, Center for Strategic and International Studies, May 18, 2017, <https://amti.csis.org/counter-co-trawler-collision/> (accessed on October 10, 2017).

1990 and 2014.<sup>7</sup> However, the timing of the embargo, as well as Japan being the only nation affected tends to point to the embargo acting as an example of economic coercion used to punish Japan so China could prove a point. Furthermore, China also held hostage the bilateral talks on the oil and gas development in the East China Sea. In this situation, China demonstrated that its economic tools can and will be used to achieve a desired political decision or punish a country that does not acquiesce to its will.

### **China Exerts Economic Pressure on ASEAN**

Not only do Brunei, Indonesia, Malaysia, the Philippines, and Vietnam assert claims in the SCS, but they all belong to the Association of South East Asian Nations (ASEAN). In an effort to work with China to resolve some issues in the SCS, ASEAN engaged China in 2012 with the hope that together they could develop a SCS Code of Conduct. Though Brunei, Malaysia, the Philippines, and Vietnam spearheaded the effort, other countries that belong to ASEAN failed to reach a consensus on what the SCS Code of Conduct should include. As a result of the failure of the ASEAN countries to unite behind Brunei, Malaysia, the Philippines, and Vietnam, questions were raised as to the level of unity that exists within ASEAN, and how much influence China exerts on ASEAN even though it is not part of the organization.

Though not located on the SCS, Cambodia, Myanmar, and Laos all belong to ASEAN. Each of these countries have strong economic and political ties to China. During the 2012 discussions on the SCS Code of Conduct, Cambodia chaired ASEAN. Prior to hosting the ASEAN forum to discuss the SCS Code of Conduct, Chinese

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<sup>7</sup> Nabeel A Mancheri, "World Trade in Rare Earths, Chinese Export Restrictions, and Implications." *Resources Policy* 46, (2015), 265.



President Hu Jintao flew to Phnom Penh, Cambodia. During that visit, China promised US\$40 million in grants and more than US\$30 million in loans.<sup>8</sup> Following the visit by Chinese President Hu Jintao, Cambodia's Prime Minister Hun Sen went to China in September 2012. During these meetings, China agreed to seven more loan agreements worth US\$500 million and another grant worth US\$24 million.<sup>9</sup> Furthermore, while Prime Minister Hun Sen was in China, he told the press that the SCS disagreements should not be internationalized and Chinese Legal Affairs Committee President Hu Kangsheng thanked Cambodia's National Assembly President Heng Samrin for "its staunch support . . . on issues related to China's core interest."<sup>10</sup> China used economic statecraft, mostly in the form of loans and grants, also characterized as state sanctioned bribes, to sway Cambodia's leaders to ensure that the SCS Code of Conduct would fail.

The blatant use of economic support to Cambodia demonstrates the lengths to which China will go to carry out its SCS strategy and vision. In this case, the pledges of loans and grants and promises of foreign investment influenced this one state, but also influenced the multinational organization that it belongs to and actively led at the time. Arguably, China bought Cambodia's votes in ASEAN on any issue that China deemed important to its foreign policy and in this case it was the SCS Code of Conduct. Still today, ASEAN has not agreed upon a Code of Conduct governing the SCS, and China's influence in the process has contributed to the organization's failure.

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<sup>8</sup> Sarah Raine and Christian Le Miere, *Regional Disorder: The South China Sea Disputes*, Abingdon, Oxon: Routledge, 2013, 127.

<sup>9</sup> Sarah Raine and Christian Le Miere, *Regional Disorder: The South China Sea Disputes*, 127.

<sup>10</sup> Sarah Raine and Christian Le Miere, *Regional Disorder: The South China Sea Disputes*, 127-128.

## **China Uses THAAD to Gain Assurances**

Following the US delivery in early 2016 of the Terminal High Altitude Area Defense (THAAD) missile system to South Korea (ROK), relations between the ROK and China took a dramatic step backwards. THAAD is a transportable defensive missile system. Though China stated that it disliked having the missiles in such close proximity to its borders, the reality is that China took issue not with the missiles but rather with the radar system. Beijing fears that the X-band AN/TPY-2 radar could be linked to other theater and missile defense systems posing a threat to China's ability to launch coordinated nuclear retaliatory strikes. In an effort to remove the THAAD missile system, China imposed various economic sanctions on South Korea.

China's economic sanctions against South Korea affected many different sectors of the economy. Analysts believe the sanctions cost the ROK more than \$7.5 billion in 2017, which equates to about 0.5 percent of its GDP.<sup>11</sup> The two industries most affected by the sanctions include the auto industry and tourism. However, the Lotte Corporation suffered the most as it was forced to sell all of its stores in China as a result of the economic sanctions. Though the economic sanctions did not lead to the removal of the THAAD missile system, the economic measures instead led to Chinese political gains in the form of strategic reassurances from the ROK moving forward. While attending the Asia-Pacific Economic Cooperation (APEC) forum, South Korea's President Moon Jae-in and China's President Xi Jinping negotiated a settlement. Unfortunately, China stands to benefit more than Seoul and its allies. Seoul agreed to the three "no's": first, no

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<sup>11</sup> Clint Work, "South Korea and China Make Amends. What Now?" *The Diplomat*, November 18, 2017 <https://thediplomat.com/2017/11/south-korea-and-china-make-amends-what-now/>, (accessed on November 27, 2017).

additional THAAD deployments in South Korea; second, no participation in a US-led strategic missile defense system; and third, no creation of a ROK-US-Japan trilateral military alliance.<sup>12</sup> Though the ROK kept the THAAD missile system, both the US and the ROK lost in many other ways.

The US potentially stands to lose the most out of this agreement. When the ROK decided to the terms of the agreement with China, its actions demonstrated a shift away from the US and toward China. Analysts Abrahamian and Son assert, “First, the agreement provides assurances from Seoul about China’s strategic position in the region. Second, the rapprochement between China and South Korea creates a better political environment for Beijing to deal with the current North Korea crisis. Finally, the agreement allows China to frame itself as the responsible power in the region.”<sup>13</sup> South Korea’s President Moon describes his diplomacy as “balanced diplomacy” between the US and China.<sup>14</sup>

Even though, China’s economic sanctions achieved a victory, the sanctions did not accomplish what they initially set out to achieve. Realizing that the sanctions would not dislodge the THAAD system, Beijing shifted its tactics to re-institute economic ties ensuring that no long-term damage would ensue to either China’s or South Korea’s economies. By cancelling the economic sanctions and improving relations, Beijing portrayed itself as the responsible stakeholder on the peninsula and as the “cooperative

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<sup>12</sup> Andray Abrahamian and Daekwon Son, “Moving On: China Resolves THAAD Dispute with South Korea,” *38 North*, November 9, 2017 <http://www.38north.org/2017/11/abrahamianson110917/> (accessed on November 20, 2017).

<sup>13</sup> Abrahamian, “Moving On: China Resolves THAAD Dispute with South Korea,” <http://www.38north.org/2017/11/abrahamianson110917/> (accessed on November 20, 2017)

<sup>14</sup> Ankit Panda, “What China Gains with its Détente with South Korea Over THAAD,” *The Diplomat*, November 7, 2017, <https://thediplomat.com/2017/11/what-china-gains-with-its-detente-with-south-korea-over-thaad/> (accessed on November 27, 2017)

power on the Korean peninsula.”<sup>15</sup> A byproduct of the improved Sino-ROK bi-lateral relations includes decreasing the US sphere of influence in the region and on the peninsula, as well as casting doubt on future US defense agreements.

### **Asian Infrastructure Investment Bank (AIIB) [China and the World]**

Even though China’s importance in the International Monetary Fund (IMF) has grown, it has shown a dissatisfaction with the rigid requirements imposed by the fund’s board of governors and executive board. China blames the US for the IMF’s refusal to bail out Thailand during the financial crisis of 1997-98.<sup>16</sup> As a result, China has promoted alternatives to established structures like the IMF. One example is the formation of a development bank with the up-and-coming countries of Brazil, Russia, India, and South Africa.<sup>17</sup> However, the most threatening Chinese alternative to the established IMF is China’s creation of the Asian Infrastructure Investment Bank (AIIB). Though the US worked hard to undermine the creation of the bank, many of its allies and partners signed up for inclusion into the bank. Signatories include Australia, Canada, France, Germany, Israel, South Korea, and the United Kingdom all of whom are key US allies.<sup>18</sup>

Even though China created these parallel structures, they continue to participate in existing structures like the Asian Development Bank, World Bank, and IMF. So why does China want to create these parallel structures and what are its goals? China argues

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<sup>15</sup> Abrahamian, “Moving On: China Resolves THAAD Dispute with South Korea,” <http://www.38north.org/2017/11/abrahamianson110917/> (accessed on November 20, 2017).

<sup>16</sup> Evan A Feigenbaum, "China and the World: Dealing with a Reluctant Power." *Foreign Affairs*, January/February 2017, 37.

<sup>17</sup> Evan A. Feigenbaum, "China and the World: Dealing with a Reluctant Power," 36.

<sup>18</sup> Evan A. Feigenbaum, "China and the World: Dealing with a Reluctant Power," 33.

that in Asia there needs to be more funding and that the current institutions will not adequately provide what is necessary. China asserts that its creation of the AIIB is a much-needed bridge to this gap. Although China's argument is sound, failing to consider its other goals would be shortsighted and naive. China's massive economic reserves and the AIIB, which it would control, could provide China with tremendous amount of economic influence in the region. Based on the economic coercion tactics that China uses on a regular basis, the question is not would they use the AIIB to promote its political agenda, but rather when will they and to what extent? If China leveraged the AIIB to promote its agenda or even strong-arm regional nations to support its agenda, it would only be another example of Chinese economic statecraft where China uses economic levers to achieve its goals.

The US and its regional allies need to look at different tools to shape or counter China's influence. Robert Zoellick, the US Deputy Secretary of State, in 2005 stated, "It is time to take our policy beyond opening doors to China's membership into the international system. . . We need to urge China to become a responsible stakeholder in that system."<sup>19</sup> China's economic statecraft poses a challenge regionally and globally. The AIIB has merit, but the bank will allow China too much influence and ultimately provide another mechanism for China to flex its economic strength to bend other countries to its will. When China does not share the same goals, values, and outlook as the US and its allies, motivating them to become responsible stakeholders in the international system is difficult. Inducing China to follow the established norms will require a collective effort from many countries big and small. It will require the use of

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<sup>19</sup> Evan A. Feigenbaum, "China and the World: Dealing with a Reluctant Power," *Foreign Affairs*, January/February 2017, 34.

diplomatic and economic trade tools to ensure that China will not force its will on other countries, and when it does exercise economic coercion the global community must acknowledge the bad behavior and sanction the Chinese.

## Chapter VI. Recommendations

*Diplomacy changes problems and challenges into opportunities – Former US*

*Ambassador*

US regional power in Asia and specifically the SCS is at stake; the threat is real and should be one of the US government's highest priorities. The US needs to demonstrate its resolve to counter China's rising influence by creating a policy and long-term strategy that brings to bear all the national instruments of power to maintain its influence in the region. The creation of any strategy is delicate because it must strike a balance between something that is executable in the short-term to deliver positive effects, while still maintaining a long-term perspective and remain achievable in the future. The various organizations involved in the creation of the strategy need to persevere and remain steadfast in carrying out the strategy. The strategy must not become episodic in nature, meaning that as new leaders come into power they discard the old strategy before reaping the full benefits and effects of it. President Obama's "Pivot to Asia" reveals the beginning of a strategy that demonstrates the importance that the US places on Asia. By shifting its focus away from other areas of the world, the US illustrates the strategic importance of the Asia-Pacific region and the importance of the economic, political, and military relationships.

China's strategy is obvious, it wants to dislodge the US as a regional power and establish itself as the regional hegemonic power. Moreover, after evaluating statements made by President Xi and actions that the Chinese government has taken, it is clear that China wants to push the US out of the region. China continually demonstrates its

economic might in the region contributing to its ability to influence policy in the region. In an effort to counter China's vision and strategy, the US needs to first, work diligently establishing strong economic ties within the region with an emphasis on the countries surrounding the SCS. Second, the US needs to work with all the SCS claimant countries to create a SCS Code of Conduct. Third, the US needs to further develop its relationships with India. Fourth, the US needs to use lawfare to reinforce the fact that the artificial islands that China created in the SCS do not meet the criteria under international law and the UNCLOS ruling to receive EEZ status. These suggestions are not all encompassing; however, including these into a long-term strategy will work to counter China's expansion in the region and slow or stymie its control of the SCS.

### **Economic Development**

Developing stronger economic relationships with the countries in Asia and India must be a priority. The US possessed a significant opportunity to further develop economic relationships with a multitude of countries by signing the Trans-Pacific Partnership (TPP). The TPP provided an opportunity to counter some of the economic influence that China maintains in Asia. Following the US decision to pull out of the TPP, the US must work to negotiate different treaties and partnerships that promote bi-lateral economic partnerships within Asia but more specifically in the SCS region that feature the US as the most trusted ally. The creation of these newly negotiated bi-lateral economic agreements will strengthen the US position in the region and increase the opportunities for the US to shape policy and security decisions that promote regional stability.



The US withdrawal from the TPP must be considered a setback in the development of these economic relationships. However, there still exists opportunities to regroup and reassert US economic might in the region by negotiating bi-lateral agreements. Negotiating economic trade agreements bi-laterally allows the US to reprioritize the most important relationships in the region. First, the US must continue to keep strong economic relations with allies and partner nations in the region. Then the US should focus on India. The relationship with India could arguably be the most important relationship with the US outside its allies. Beyond the large population providing a tremendous market for economic growth, India controls the strategically important western entrance to the Straits of Malacca. Following India, the US should be focusing on the nations that surround the SCS and then the rest of the ASEAN nations.

Countering China's economic advantage in the region will mean the US playing the same game that China plays, only it must learn to do it better. The US must make every attempt to create bi-lateral trade agreements and improve relationships with the SCS countries that equal or surpass the importance that China has with those countries. Strong economic relationships will allow the US to help shape policies to ensure that the SCS remains an open global common and counter any Chinese policies that would threaten the safety and security of the SCS.

### **South China Sea Code of Conduct**

ASEAN's failure to negotiate a cohesive SCS Code of Conduct to leverage against China and China's overbearing and threatening policies in the SCS present the US with an excellent opportunity. The US, as an honest broker, can engage each of the

six regional nations Brunei, China, Indonesia, Malaysia, Philippines, and Vietnam that all assert claims to the waters, islands, reefs, shoals, ocean floor and resources under the ocean floor, and try and negotiate a SCS Code of Conduct.

A SCS Code of Conduct should include at a minimum five important items. First, an agreed upon map that details each of the claimants' territorial and EEZ borders that includes the removal of the nine-dashed line. Second, an agreed upon method for handling any infractions, such as a special court of arbitration. Third, a statement that ensures that the Straits of Malacca will remain open. Fourth, no further creation of artificial islands or reclamation activities. Fifth, an agreement that any waters outside the newly established territorial and EEZ borders would be shared commons open for economic exploitation but not for any militarization development.

Currently, ASEAN is attempting to take the lead on this project, however as previously discussed China has influenced the process through its application of economic pressure on Cambodia and Laos. China's political, economic and military influence in the region and its desire to control the area located within the nine-dashed line provides an unfair advantage over any country trying to negotiate a deal. These facts open the door to the US possibility of working with other countries in these negotiations.

China desires to negotiate with each nation individually. Logically this makes sense from China's perspective. China believes that negotiating with each country individually will enable its government to reach a better deal. For this reason, the US should attempt to unite the smaller countries in an effort to strengthen their position of power in negotiations with China. In addition to acting as an honest broker to help negotiate a SCS Code of Conduct, the US would demonstrate its importance in the region

and build stronger relationships with the other five SCS claimants, Brunei, Indonesia, Malaysia, Philippines, and Vietnam (the South China Sea Group of Five (SCSGF)).

The US needs to outline a two-part process to develop a SCS Code of Conduct. The first part of the process will be to invite Brunei, Indonesia, Malaysia, the Philippines, and Vietnam to participate in multinational negotiations over the SCS. Convening multinational negotiations and acting as an honest broker throughout the process the US can build deeper relationships with each of these countries. The US needs to emphasize that coming together as a group will give them greater collective bargaining power. In addition, negotiating outside of ASEAN will help to ensure that China will not be able to wield its influence in the process.

After a consensus is developed then the US can implement the second part of the process; negotiating with China. Negotiating with China as a unified group will help to level the field and possibly give the SCSGF the ability to negotiate from a position of power. Even if they are unable to get China to the negotiating table, they may be able to sway international opinion in their favor. Ensuring that every country achieves a reasonable amount of success during negotiations will be an important component to solidifying the US reputation as an honest broker, while also improving relations with the group of five.

If the SCSGF will not convene in multinational negotiations together to determine the code of conduct then the US should negotiate with Vietnam and the Philippines first. These two countries pose the most challenges to China and share overlapping claims. Vietnam has confronted China on maritime issues before. The Philippines also challenged China on maritime issues, eventually suing China in the Permanent Court of

Arbitration in the Hague over their SCS claims as defined in the UNCLOS. Gaining an agreement from Vietnam and the Philippines would demonstrate to the other nations that the code of conduct is attainable and put pressure on China. Then the US should work with Brunei, Indonesia (already negotiated with the Philippines and Singapore on boundaries in 2015), and Malaysia simultaneously.<sup>1</sup> Their proximity to each other and overlapping claims makes negotiations with each other meaningful and practical. If Vietnam and the Philippines come to an agreement followed by Brunei, Indonesia, and Malaysia, then bringing them all together in one forum to finalize negotiations on the code of conduct should be attainable.

The challenges that China brings to the SCS with its nine-dashed line policy and its influence that it wields within Asia presents the US diplomatic opportunities and opens the door to help negotiate a South China Sea Code of Conduct. Ultimately, the US will benefit from taking a leading role in this initiative and help to force China to the negotiating table and in the process weaken China's grasp over the region.

## **India**

As mentioned above, India could potentially be the most important relationship for the US outside its allies. The US needs to continue to nurture and expand its diplomatic, economic, and military relationship with India. The US and India share democratic ideals that form the foundation of the diplomatic relationship. India also shares many of the same concerns and suspicions that the US has toward China. India

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<sup>1</sup> Joe Cochrane, "Indonesia, Long on Sidelines, Starts to Confront China's Territorial Claims," *New York Times*, September 10, 2017. <https://www.nytimes.com/2017/09/10/world/asia/indonesia-south-china-sea-military-buildup.html> (accessed February 13, 2018).

has felt China's encroachment on its borders and seen the economic pressure it applies in the region. China's OBOR project is one example that threatens India's economic growth in the region.

India poses an interesting problem to China because the two countries border each other, both countries have populations totaling over one billion people, and both of their economies are on the upswing. Beyond the US diplomatic efforts, strengthening economic ties with India will benefit both countries. There exist many different industries, especially in the science, technology, engineering, and mathematics (STEM) fields, that the US and India share interests in and can further develop. Continuing to strengthen and expand the established economic relationship will bring both India and the US closer together.

The US also needs to look at expanding and improving its military relationship with India. The US can grow its military relationship with India through continued foreign military sales and further participation in bi-lateral exercises. India recently purchased P-8 Poseidon aircraft from the US. The robust military industrial complex in the US produces many capabilities that would fulfill many of India's requirements. By increasing military sales to India, the US would share common equipment thereby improving interoperability between the two militaries. Increasing bi-lateral or multi-national participation in exercises symbolizes another way of improving interoperability. Increasing participation in exercises results in greater understanding between the two militaries. Ultimately, expanding the interoperability between each of the militaries demonstrates to other countries in the region the United States' resolve to remain a leader and active participant in the Asia-Pacific region.

Coming closer together diplomatically, economically and militarily demonstrates the importance that the US places on the relationship. Investing time and assets into the development of the relationship with India could result in many benefits. By further developing deeper ties with India, the US adds a valuable ally to counter China and its expansion in the region signifying the greatest benefit from improved the bi-lateral relationship.

## **Lawfare**

China's policies and actions demonstrate that it desires to become a world leader diplomatically, economically, and militarily. Prestige on the world stage is an inherent byproduct of becoming a world leader. Employing tools to counter China's prestige would provide US leaders decision space to maneuver and shape the diplomatic and the economic environment. US leaders can quell the surge in China's prestige through the application of Lawfare. The former US Air Force Deputy Judge Advocate General, Major General Charles Dunlap, defines lawfare as, "the strategy of using – or misusing – law as a substitute for traditional military means to achieve an operational objective."<sup>2</sup> Though China is not known for its fair internal rule of law, China operates throughout the world and is subject to the legal norms that exist in the international community. For that reason, the US needs to employ lawfare to create effects that bring into question China's resolve to operate according to the international legal norms.

The ruling by the Permanent Court of Arbitration in the Hague regarding the dispute in the SCS between the Philippines and China opens the door for the US to use

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<sup>2</sup> Charles J. Dunlap, Jr., "Lawfare Today: A Perspective," *Yale Journal of International Affairs* Vol 3, No. 1 (Winter 2008): 146.

lawfare. The US should support partners and allies by advocating a lawfare campaign against China as a forcing function to settle some of the territorial disputes in the SCS and counter the illegal nine-dashed line claims. Along with advocating and supporting the litigation, the US will need to continue to press China to act in accordance with the legal rulings and international law.

In addition to supporting partners' and allies' use of lawfare to settle disputes in the SCS region, the US should look for other areas to conduct lawfare. China consistently demonstrates its propensity to use its economic might as a tool of statecraft. The US should demonstrate its command of the legal system and use lawfare as one tool to counter China. Again, believing that China will probably not adhere to any legal rulings, the ultimate goal of conducting a lawfare campaign will be translating a win in the courtroom into a campaign in the court of world opinion to then discredit the Chinese government's respect of law and international norms as well as erode China's international prestige. Through collaboration with allies and partners, but if necessary through unilateral efforts, employing lawfare will provide effects creating maneuver space for decision makers while reducing China's prestige in the international community.

## Chapter VII. Conclusions

China's policies, strategy, and actions demonstrate its resolve to become a world power that dictates its own agenda. As its power and stature in the international community has grown over the last thirty-years, it has asserted that the SCS is a priority issue. China believes its security and prosperity is intrinsically tied to the SCS. China has taken an aggressive approach to combatting the competition that exists in the SCS by declaring the nine-dashed line policy and recently engaged in an island building campaign. President Xi understands that maritime power and control of the SCS will enable China to reach its goals of regional hegemony and eventually becoming the preeminent world power. Examining comments President Xi Jinping made regarding the SCS confirm this.

China recognizes that in order to control the regional waters that surround it, China must employ its strongest tool, the economic power that it wields internationally. China continues to demonstrate its economic might and put into place economic measures forcing other nations to acquiesce to its terms that ultimately translates to its version of economic statecraft. China demonstrated its adroit ability to use its economic statecraft influencing Cambodia, Japan, South Korea, and other nations to bend to its will. Now, the OBOR initiative will further enhance China's ability to employ economic statecraft and influence nations from Asia, Africa, and Europe. China's stable and uncompromising push with economic statecraft has shaped the SCS and its ascension to one of the two most powerful countries in Asia-Pacific region and its rise as a world power.



The US, being the other most powerful nation in the Asia-Pacific region, also views the SCS as a vital strategic interest necessary for its security and prosperity. US regional power in Asia and specifically in the SCS is at stake and should be one of the highest priorities. Besides losing the ability to operate freely in the SCS with China's implementation of the nine-dashed line and the creation and militarization of the artificial islands, the US also risks losing relevance in Asia.

The US must counter China's economic statecraft in the SCS to demonstrate its resolve to its allies and partners and remain relevant in Asia. The surest method of demonstrating US resolve in the region will include the development of a long-term strategy. The following four recommendations should be incorporated into a long-term strategy. First, establishing strong economic ties within the region, but specifically the countries surrounding the SCS. Second, collaborating with all the countries that surround the SCS to create a SCS Code of Conduct. Third, further developing its diplomatic, economic, and military relationships with India to counter China's expansion in the region. Fourth, using lawfare to counter China. These four measures will improve the US ability to remain relevant in the Asia-Pacific region and a foil to China's rising power in the region.

Only time will tell what China's ultimate end-game will be. However, the Chinese government knows what it wants to accomplish. It appears to have implemented its vision and long-term strategy through its various policies and actions. The US needs to ensure that it is ready to employ its strategy and be poised and prepared to counter the rise of China to remain relevant in the region. If the US fails to implement a strategy in

the SCS, then the loss of the SCS will be the first indication of its impending regional decline.

## **Abbreviations**

AIIB: Asian Infrastructure Investment Bank  
AIP: Air-Independent Propulsion  
APEC: Asia-Pacific Economic Cooperation  
ASEAN: Association of South East Asian Nations  
CCP: Chinese Communist Party  
DoD: Department of Defense  
EEZ: Exclusive Economic Zone  
FDI: Foreign Direct Investment  
FONOPS: Freedom of Navigation Operations  
IMF: International Monetary Fund  
JCG: Japanese Coast Guard  
MFA: Ministry of Foreign Affairs  
MSRI: Maritime Silk Road Initiative  
OBOR: One Belt, One Road  
REE: Rare Earth Elements  
ROK: Republic of Korea (South Korea)  
SCS: South China Sea  
SCSGF: South China Sea Group of Five  
SREB: Silk Road Economic Belt  
STEM: Science, Technology, Engineering, and Mathematics  
THAAD: Terminal High Altitude Area Defense  
TPP: Trans-Pacific Partnership  
UNCLOS: United Nations Convention on the Law of the Sea  
USPACOM: US Pacific Command

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## **Biography**

Commander Bradford “B-Rad” Wallace, USN was commissioned in May 2001 after graduating from the United States Naval Academy, where he earned a Bachelor of Science degree in Political Science. He was designated a Naval Aviator in October 2002, and as a junior officer was assigned to HSL-37 at Kaneohe Bay, HI and as a department head to HSM-78 in San Diego, CA. He also did an operational tour onboard USS Wasp (LHD-1) in Norfolk, VA. Ashore he was assigned to HT-28 at NAS Whiting Field as an Instructor Pilot. Most recently, he served as an Action Officer at U.S. Strategic Command (USSTRATCOM) in Omaha, NE. Additionally, he earned a Master of Business Administration with an emphasis in Aerospace and Defense from the University of Tennessee in 2015.